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STRATEGY

2009 Outlook: Sectors and Themes

In the past two weeks we have published our asset allocation, macro and regional view for 2009. Our macro view is that we are in the biggest economic and financial crisis since 1945 and that it will take two to three years for GDP growth to revert to trend, mainly owing to US$5trn of excess leverage globally. We are a small overweight of equities, with an end-2009 S&P 500 target of 1,050, and we prefer credit to equity. Our top regional overweight is NJA (we are also a small overweight of the US). Our regional underweight is Continental Europe.

Our sector & themes views: **we have a bar-bell approach of overweighting defensives** (telecoms, US and UK drugs and tobacco) and **preferring to play beta through the credit-related plays (insurance) and some consumer plays in Non-Japan Asia.** The outcome to global growth is too binary to have either a very high beta or low beta view.

Our top themes: **(1) Play beta through the credit-related plays** (non-life, life insurance, high leveraged defensives with high FCF, UK property, which we raised to benchmark a month ago). **(2) Avoid corporate discretionary spend** (our largest underweight)—capital goods, hotels, airlines, media, IT services. We continue to prefer the consumer to the corporate. **(3) Non-Japan Asia will lead the recovery in global growth**—chiefly via the consumer. **(4) Buy big caps with high dividend yield.** Avoid high leverage companies with low FCF, but do not avoid leverage altogether as 'safe' leverage should outperform if spreads falls. **(5) Focus on short-cycle industries used to deflation**—telecoms and technology (retailing also fits into this theme although we are a small underweight). **(6) 'Masters of their own destiny'**—companies with sustainably high CFROI® (with low volatility), below peer group leverage and bargaining power (as proxied by low working capital): BAT, Nestle, Reckitt Benckiser, TNT, Staples, PepsiCo, Air Products. **(7) How to play infrastructure** (and how not to!).

Sector changes: *We lower our weighting in oil to underweight from benchmark. We lower regulated utilities to benchmark from overweight.* We continue to add money to higher beta areas (insurance, technology and consumer cyclicals). Our non-consensus overweight is technology, where we prefer the consumer-related areas.

Overall, we have been reducing our defensive overweights in food producers and energy utilities over the past month, adding to credit plays (insurance) and reducing the size of our underweights in consumer cyclicals areas (autos and UK retailing). We stay a small underweight of banks—but like underleveraged banks in underleveraged countries (Resona, ICBC, KBC, Alpha, Intesa). *We prefer credit plays to cyclicals and prefer underleveraged banks to late cycle (ie, corporate spend-related) cyclicals.*

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2009 outlook themes/sector: Executive overview

We published our asset allocation on 9th December and our regional allocation on 2nd December. We now focus on sectors and themes.

We find the sector/thematic view much more complex than in previous years, as many of our calls for 2008 (avoid leverage, overweight non-cyclical high FCF, overweight defensives) have played out and are now reflected in stock prices.

Overall, we have a bar-bell approach of overweighting defensives (telecoms, US and UK drugs and tobacco) and **playing beta through the credit-related plays and some consumer plays in Non-Japan Asia**. We are not brave enough to be very low beta (ie. policy can never work) or very high beta (ie, the world can cope with US$5trn of excess leverage).

We lower our weighting in oil to underweight (and prefer to play a China-related infrastructure story via steel).

Overall, we have been lowering the size of our overweight in defensives (by reducing weightings in food producers and energy utilities over the past month), adding to credit plays (insurance) and reducing the size of our underweights in consumer cyclical areas (autos and UK retailing). Thus, we have been adding to beta.

Our non-consensus overweight (albeit small) is technology, where we focus on consumer-related plays. Our big underweight is still capital goods and most corporate spend-related areas (hotels, media, airlines).

We stay a small underweight of banks, but focus exclusively on underleveraged banks in underleveraged countries.

We prefer credit plays to cyclicals and prefer underleveraged banks to late cycle (ie, corporate spend-related) cyclicals.

Key themes:

(1) Play beta through the credit plays

This is our most important theme. The implied cumulative five-year default rate on high yield is above 60%, worse than the peak historical default rate of 46% in 1935. Yet, in the 1930s nominal GDP halved and unemployment peaked at 25%. Credit led equities during the last market trough (2002/03) and has outperformed equities during the past two recessions (in the early 1990s and in 2001). Our preferred way of playing credit is:

(a) Insurance—our largest overweight. Non-life insurance still trades on a 24% discount to its P/B norm and the dividend yield premium of 39% to non-financials compares with an average 26% discount. The sector still discounts a CFROE of just 5.1% on HOLT (the 20-year average is 7.9%). Yet, non-life insurance benefits from two counter-cyclical elements: a) a general shortage of capital, especially following the demise of AIG, forces up premiums; and b) claims, especially in motor, tend to be cyclical. Relative earnings momentum has just turned up. On our screens, buy: Swiss Re, ZFS, Ace, RenaissanceRe.

Life companies are a high beta play on credit with larger portfolios and lower quality credit portfolios than non-life companies. Valuations look very attractive—the implied CFROE is just 1.3% (well below the discount rate of 6%) and P/Bs are at a 40% record discount to the market (compared with a long-run average 15% premium). Life companies have underperformed banks by nearly 60% over the past ten years but life companies have less regulatory risk, less liquidity risk and less new funding needs than banks (with capital raising just 3% that of banks). Life companies benefit from a steeper yield curve and we suspect they have learnt some lessons from 2002 (in terms of longer duration liabilities than assets and historical guarantees). In the UK, Resolution is raising money to buy closed-end businesses. Buy: Aegon, MetLife and Ameriprise Financial.

(b) Buy leverage selectively. Companies with high leverage but high FCF in non-cyclical areas: DT, Swisscom, Henkel, Ahold and in the US Heinz (HJ), CVS Caremark, Public Service Ent, Smith Int. A slightly higher beta play is cyclicals that have debt of less than 100% of market cap and whose CDS spread is below 200bps. This highlights KPN, DSM, Du Pont, CVS, Stanley Works.

(c) Underleveraged banks—focusing on those in underleveraged countries. This particularly highlights Alpha Bank, Intesa, STAN, Resona, ICBC. Soc Generale and Goldman Sachs are among the stocks with the highest correlation to credit in Europe and the US and we would own these stocks.

(d) Credit fund managers: Aberdeen, Legg Mason and Alliance Bernstein.

(e) Property has the fourth highest correlation to credit and we raised UK property to benchmark a month ago (it is our preferred UK domestic play). We believe that property, after adjusting for a 20% fall in rents, should be on a 7% yield. Adjusting for leverage this requires a 55% discount to NAV- UK stocks are now slightly below this level. Its P/B is 30% below its early 1992 trough. UK property has underperformed US property by 25% in the past month. Buy British Land.

(2) Avoid corporate discretionary spend

Once GDP growth turns negative, capital spending in the US typically has a beta of five to GDP and capital spending does not usually turn positive until GDP grows above 1.5–2%, something we do not see happening until 2011. The best lead indicators of US capital spending point to investment falling nearly 15% y/y from -4% y/y now. The global investment share of GDP is higher than at an all-time high, 11% above its 20-year average. In the 1930s, US investment fell 81% in real terms. The gap between the cost of capital and RoE for the US market is now close to zero; as it continues to fall, corporates will likely choose to pay off debt rather than invest. Moreover, with 41% of the market trading below replacement value, it is cheaper to buy than build. The capital goods sector is 17% above its norm on P/B relatives in Europe.

We would be particularly cautious of short-cycle capital goods (Legrand, Geberit) and capital goods stock with resource exposure (Atlas Copco, ABB, Sandvik). In the US, the following names are expensive on P/B relatives: Paccar (which is also expensive on HOLT), Parker Hannifin, with our analysts' least preferred stock being Rockwell. We are cautious on those industries that rely on corporate spend (IT services, media, hotels, capital goods and airlines have 95%, 70%, 70%, 70% and 50%, respectively, of their expenditure reliant on corporate spend). These industries underperformed by 15% in the 18 months after the last two recessions yet have outperformed 6% since the start of this recession and in aggregate trade on P/E relatives in line with their norm (with P/B relatives 30% above). When we rank these sectors on valuation and EPS beta with capex, the best ranked sector is media and the worst are capital goods and airlines.

Sell: BA, Prosieben, Havas, Ericsson, JC Decaux, Marriot, Vmware (all stocks have downside on HOLT).

(3) Short asset-life industries used to falling prices:

Short asset-life companies could be best suited to deflation. The shorter the asset life of an industry, the easier it is to shed excess capacity and for many short asset-life industries falling prices is the norm. This would highlight technology and to a lesser extent telecoms and retailing—all of these industries outperformed in Japan during its deflation. We highlight short asset-life companies in industries used to deflation where EPS has been positive for eight out of the past ten years: SAP, Qiagen in Europe and Apple, Citrix and Dell in the US.

(4) 'Masters of their own destiny'

These are companies that have persistently had high CFROI®s relative to the market with a low CFROI® volatility. In addition, we look for 'masters of their own destiny', which we define as companies that have less leverage than their peers (so they can outlast their rivals into a downturn), high FCF yield, are large cap and have bargaining power (proxied by low working capital). This highlights BAT, Nestle, TNT, Reckitt and Reed Elsevier in Europe as well as Staples, Pepsico, United Technologies, Air Products and Public Service Enterprise in the US.

(5) Buy domestic Non-Japan Asia

We believe that any recovery in global growth has to be led by Non-Japan Asia (NJA). NJA has the healthiest balance sheets (a gross savings ratio of 43% compared with 13% in the US with private credit-to-GDP below levels of ten years ago; banking systems have a loan/deposit ratio of just 78% and a current account surplus of 2.5% of GDP); the most macro response potential (government debt-to-GDP is just 33%, FX reserves are c 40% of GDP compared with 20% a decade ago); and benefit the most from falling commodity prices (very high net oil imports and food is a third of CPI). The positive gap between NJA and OECD lead indicators has remained unaltered. NJA historically outperforms two months prior to the upturn in lead indicators on eight out of the past nine occasions. NJA is pegged to the US dollar and thus benefits from the Fed move to zero. NJA also has one of the most flexible labour forces (using the Economic Freedom index).

We focus on the more consumer, real estate and banks-related plays. Buy: CMHK, PLDT, China Life, UOB, ICBC, Sun Hung Kai Properties. Directly, we choose countries with current account surpluses, net foreign assets, low loan-to-deposit ratios and oil importers: this favours China, Hong Kong, Philippines. Indirectly, for consumer plays, buy Standard Chartered, Yum Brands and Swatch.

(6) Infrastructure

Global fiscal easing already amounts to US$1.3trn and is rising. Of this globally roughly a third will be spent on infrastructure and in some countries the proportion is even larger: Spain (70%), China (c 60%) and US (could be as high as 50%). (Yet, only around 10% of the fiscal easing announced in the UK Pre-Budget Report will be spent on infrastructure).The big problem, in our view, is that very few companies have enough exposure to infrastructure to offset the sharply deteriorating trends in short-cycle capital goods and some of the long-cycle areas (power generation) will be affected by the falling demand for new power capacity, with electricity demand likely to be slower going forward. We would tend to focus on the greener areas (wind, where the break-even is much lower than solar), lighting (where there is a two-year payback and lighting accounts for 11% energy use in the US), smart buildings, railways. The following stocks generate more than 20% of business from infrastructure: Honeywell, URS, Nucor, Vinci, Philips, Gamesa, Quanta Services, China Southern Locomotive, China Railway.

(7) Style: Go for dividend yield and stay big.

Focus *on dividend yield and big cap. Avoid high leverage and low FCF but not leverage altogether.* We believe strongly that high dividend yield will outperform in 2009. In the past four bear markets high dividend yield has outperformed as it did in the first year of the last bull market. In addition, we believe retail investors will focus on yield as the worst earnings momentum ever means investors will likely feel more comfortable with yield than earnings. In our view, the market is too pessimistic on dividends with swaps discounting a 35% fall in DPS in *both* 2009 and 2010. The P/E of high yield stocks is in line with its average. We focus on companies with a dividend yield 1% above government bonds and with CDS spreads below that of their governments: Alleanza, Santander, Snam Rete Gas, Telekom Austria and Public Service Enterprise Group. We also highlight outperform-rated stocks with yields above 5%, positive dividend growth being forecast from 2007–10 and CDS below market median (where available): British Land and Deutsche Telekom in Europe and Lorillard and Public Service Ent. Group in the US.

Big cap should have outperformed much more given the rise in credit spreads (it has a higher credit rating than small cap), the rise in VIX (high volatility implicitly means investors should favour diversified business models) and the virtual collapse in lead indicators. Big cap has better funding ability on loan officers surveys and can access Fed funding programmes. Above all, the illiquidity of small cap has been revealed. Big cap in US and the UK trade on 15% and 9% respective discounts to their norm relative to small cap, Europe trades on a 15% premium. On HOLT, the discount rate in the US for large cap is the same as small cap. However, small cap are clearly higher risk, in our opinion, on both financing, credit and liquidity grounds.

We would avoid very high leverage and low FCF companies (Fraport, Kingfisher, BA, Holcim, Areva, DR Horton, Marriot, AMR Corp, Starbucks, MGM). However, we do not want to avoid third-quartile leverage. Low leveraged companies outperformed high leverage companies by 80% in the past year; low leverage companies trade on a 20% P/E premium to high leverage (against a norm of 10%) but above all leverage as a style performs in line with credit spreads and we think that credit spreads are very unlikely to rise in 2009.

Major changes in sector recommendations:

Oil: From benchmark to underweight
We had focused on big cap oil for its defensive characteristics. We now take it to underweight as:

(a) the big cap oil is no longer cheap. If we adjust for under-depreciation the P/E relative of oil is 2.3std or 26% above its average in Europe and 2.7std or 37% above the norm in the US). On HOLT, big cap oil is discounting a CFROI® of 6.1% (compared with a 20-year average of 5.1%). This implies a mid-cycle oil price of US$62pb.

(b) we worry that oil could stay in the US$35–US$45pb range (against consensus of US$70 on Reuters and US$63 on Bloomberg for 2009 and a two-year forward price of US$60). Once OPEC spare capacity rises above 5%, OPEC tends to lose pricing ability. This is already the case for 2009 but if the US and European oil demand falls 7%, OPEC spare capacity should stay above 5% until 2012. However, US oil demand is already down 9% yoy despite the collapse in gasoline prices (recall half of oil demand comes from Europe, Japan and the US). Only around 10% of oil production is below total break-even, yet 50% of copper and 100% of platinum are below total break-even levels—and they also have cartels and high depletion rates.

(c) being overweight oil is very consensus on both analysts' recommendation and Frank Russell data. Commodity ETFs and open futures positions are still at 2006 levels. Owning commodities ETFs was an inflation hedge and not a deflation hedge.

(d) the leaders of the prior bull markets underperform in the following bull markets;

(e) big cap oil has benefited from its very high interest cover and low CDS spread. However, if credit spreads fall, as we expect in 2009, low leverage may not outperform. We are most cautious on OFS (as it is now much cheaper to buy than build). Our analysts would express relative caution on: Statoil, Sinopec, Rosneft, ConocoPhillips.

Stay underweight mining:
Industrial commodity prices trough on average *four months after* the trough in global IP growth (which is likely to be April); industrial commodity prices often trough when as much as 40–50% of production is below the cash cost. Currently less than 10% of copper, iron ore and coking coal are below cash cost. China's fixed investment looks set to slow from 24% to around 10% in nominal terms, with infrastructure only accounting for a quarter of total investment and clear residential overbuild (residential construction is up 7% yoy yet new homes sales are down 27%); the price of miners relative to industrial commodity prices is mid-range as is the P/B relative to the market. Platinum looks the most interesting of the metals with nearly all of production below breakeven.

Benchmark steel: We would play any China infrastructure rally via steel; 40% of production is below the cash cost; steel benefits from falling energy, iron ore and coking coal prices (which account for about 50% of inputs); steel looks abnormally cheap on HOLT trading on 80% of replacement value and the 'cartel' is actively cutting production. Buy Salzgitter, Nucor.

Stay overweight gold: In our view, all global policy makers will soon realise that there is only one goal: create negative real rates by printing money, spending and capping interest rates across the curve.

Regulated utilities: From overweight to benchmark

This had been our non-consensus overweight. Historically, regulated utilities outperform when index-linked yields fall or inflation rises. Yet they have outperformed by almost 9% since July despite a sharp rise in indexed-linked bond yields (from 1.1% to 2.0% in the UK). They are not suited to deflation (given their RPI links)—each 1% pt off RPI takes 1.5–3% pts off RoE for UK water stocks. In addition, customer bad debt charges may rise and a sharp deterioration in government finances may leave them vulnerable to a windfall tax. We now find that regulated utilities have become expensive: with a P/E premium of 27% to the market ex financials (compared with a norm of 20% discount); the yield premium to the market ex financials is just around 10% (an all-time low). Finally, low FCF and very high leverage could be a problem. Relative earning momentum has peaked. Our utilities team would be most cautious of Severn Trent and Enagas.

We offset these two downgrades by adding slightly to consumer cyclicals (to be less underweight), insurance (to be more overweight) and technology (to be a small overweight).

Technology: This is the only cyclical sector that we are overweight

We are overweight as:

(a) this sector has the shortest asset life of any sector (average of ten years) and has had consistent deflation. It is therefore better suited to a global environment of record excess capacity and falling prices (as it can rid itself of excess capacity quicker than longer asset-life sectors);

(b) net technology investment share of GDP is low at 0.7% and is 20% below its long-run average. In a cost-cutting environment the need to boost productivity increases and technology is one of the best facilitators of this (especially if real wage growth rises—as it likely will in 2009);

(c) valuations look OK—the P/Sales of global tech is right in line with its ex-bubble average of 1.1x; 2008E FCF is high at 11%, 9% and 7% for hardware, software and semis;

(d) the technology cycle is well managed compared with other sectors. Excess inventory is less than other sectors on our data and the volatility of the inventory and capital spending cycle are greatly reduced. Moreover, the sector has a net cash position of 1% of market cap and has seen a structural rise in asset turns in the past four years. Its rolling beta in the US is at an all-time low of 0.8x from 2.2x in 2001. Hence technology has become a *defensive cyclical*!

We admit that the difficulty with this call is our concern over corporate discretionary spend with 95%, 80%, 66%, respectively, of IT services, software, PC spend being corporate spend related but some areas have high maintenance spending (parts of software) and as above technology spending is productivity enhancing. We focus on *consumer*-related areas of technology (Apple, Qualcomm, Acer, HTC) and areas reliant on high maintenance capital spending (Microsoft, SAP). It is also worth focusing on, in our view, areas where more than half of production is below the *cash* cost (DRAM in particular and TFT-LCD to a lesser extent)—therefore Micron.

Cyclicals: We stay underweight cyclicals (as we have been since July 2007) because:
(a) we believe it will take at least two years for growth to revert to trend given US$5trn (or 21% of GDP) of excess leverage in the G4 countries (US, UK, Germany and Japan; US$2.5trn for the US consumer alone); 1.7m excess inventories of US homes (that will likely take two years to absorb); a still substantial overvaluation of housing in Europe and Japan and currently the tightest bank lending conditions on record (which would be consistent with a 5% reduction in loans over the next 18 months). Thus we believe cyclicals should be the cheapest that they have been on our database. However, that is not the case. On HOLT European and US cyclicals discount CFROI®s that are well above the lows of the past ten years (and in the US case above average levels), the P/B of cyclicals relative to defensives is still 18% and 23% above its lows (more so if we look at the P/B relative to the market).

(b) Cyclicals should have underperformed by another 10% on our models (based on lead indicators, bond yields, earnings momentum and risk appetite). We would not buy cyclicals before bond yields start rising (70% of the time that happens cyclicals outperform) and lead indicators turn up (typically the time to buy cyclicals is two months before the trough in lead indicators). This implies late Q1/early Q2. I/B/E/S margin assumptions in Europe appear bizarre at 3.6% pts above average levels and adjusting for 'average' margins leaves cyclicals on a 12m fwd P/E of 16.6x and 18.3x in Europe and the US—not obviously cheap. 2009 cyclicals consensus revenue estimates have only fallen 6% and 3.8% in the past six months in Europe and the US to be -0.3% and 3%, respectively. Investors still appear to be a small overweight of cyclicals, according to Frank Russell data. We believe the catalysts to buy will be: signs that inventory de-stocking is complete (late Q1); US housing inventory peaking (early Q2); and a fall in credit spreads or just valuation (ie, another 15–20% underperformance of cyclicals)

We rank all cyclical sectors on valuation (P/B, value to cost and P/Sales), earnings sensibility (the degree to which margins and revenues are above their norm), leverage and earnings momentum. In Europe, construction, transport, capital goods and autos rank worse and software, commercial services, tech and media the best. In the US, construction, transport and hotels & leisure rank the worst; retail, commercial services, media and semis the best.

We prefer consumer plays to corporate spending as tax cuts, interest-rate cuts and falling commodity prices help the consumer. If we were to enter severe deflation, prices would fall faster than wages, hence real wage growth would increase. As a consequence, we are now only marginally underweight **autos** on page 127 (auto sales per capita in the US is the lowest on record, valuations are cheap and most concerns are now well understood. However, very high operational leverage and global market shares targets that add up to 120% leave us with a small underweight). We are now only a small underweight of **UK retail** on page 130 (having raised weightings a month ago, largely on the basis of valuation, rate cuts and store closures but we are not brave enough to go overweight because: (a) floor space is still growing at 1% while we expect retail sales to contract by -4% in 2009, projecting the savings ratio to rise to 5% by early 2010 from 0% currently; (b) the lagged effect of sterling weakness with half of the costs being foreign currency denominated; (c) the internet limits the impulsive buyer; and (d) Tesco's winning share on lower gross margin over non-food retail).

Defensives:
We rank all sectors on our 'defensiveness' scorecard (based on correlation of earnings and price with OECD lead indicators, leverage, volatility of CFROI® and earnings). On this basis, the most defensives sectors are (in order) pharma, food producers, tobacco, software, household products and telecoms. We took food producers down to benchmark on November 12. Our key defensive overweights are tobacco (BAT, Altria, Imperial), drugs and telecoms.

Telecoms: We raised to overweight in early July.
Telecoms have the following characteristics that we like:

(a) they are one of the highest dividend yielding sectors (and dividend yield as a style should outperform);

(b) they are highly leveraged (to provide some beta if credit spreads fall);

(c) relative non-cyclicality (a negative correlation with lead indicators and below average income elasticity of demand). Telecom spend as a proportion of income is at 30-year lows whereas in 2000 it was at a 30-year high, which should also help limit their cyclicality.

(d) the sector has been used to deflation and benefits from the credit crisis as it forces second-tier operators to merge;

(e) some degree of self-help—according to Credit Suisse's European telecom equipment team up to half of capex could be discretionary;

(f) valuations look OK: the implied CFROI® on HOLT is only in line with utilities (which seems reasonable), it has a yield premium of 17% to the market (compared with an ex bubble average of 5% premium). European telecoms are still trading on a 23% P/E discount to US telecoms. Net margins and CFROI® have now fallen to be almost the same as utilities, perhaps limiting regulatory risk; and

(g) relative earnings momentum looks very strong.

Credit Suisse's European telecoms team would highlight DT, Telefonica, Swisscom, Inmarsat, Mobistar.

UK and US Drugs:
It is the most defensive sector on our scorecard as it has one of the lowest leverage levels, the lowest correlation with lead indicators and the most untapped self help (with SG & A and R&D being triple the market norm). In the UK, the dividend yield relative to the market ex financials is still 6.5% above its average (37% in the US) with 2009E FCF yields of 9.4% in the UK and c 11% in the US. HOLT-based valuations also look reasonable. Politics, pricing and patents remain the usual bugbears, but we note the US drug producer price inflation has risen sharply recently and even US net product flows seem to be improving. In short, the structural problems in the drug industry appear less than the cyclical problems in the economy. Buy Schering Plough, Wyeth. UK drugs have the second best earnings momentum of any UK sector and are the largest overseas earner – this points to Astrazeneca.

We reduced energy utilities to underweight in mid-November
The price of power is close to an all-time high relative to oil with the power price now being close to the cost of the new entrant for CCGT. Relative valuations do not look cheap. The CFROI® is above regulated utilities. The 2008E FCF of 4.3% looks poor.

Banks: We are a small underweight
Valuations are not yet cheap. Historically in a 'normal' banking crisis, banks trough on 0.7x tangible book yet European and US banks trade on 0.9x and 1.7x tangible book, respectively. Stress testing tangible books leaves European banks on 1.2x tangible book. If anything this crisis is worse than the average banking crisis—owing to the level of bank and consumer leverage and the reliance on dis-intermediation—hence valuations should be cheaper than the 'normal' 0.7x tangible book.

Property: Banks are geared plays on property (57% and 68% of US and UK bank exposure is to property and construction-related areas) and have historically troughed a year before the trough in property prices. However, apart from Germany and mildly the US, property is not yet obviously cheap (indeed it is clearly expensive in most of Europe and Japan).

More capital raising: We estimate US$200–US$600bn of additional capital raising is required for US and European banks (even the worst-case scenario only assumes write-offs equivalent to 10% of GDP for the obvious countries—in Japan the banking crisis write-offs were nearly 20% of GDP). This would result in 7–20% further shareholder dilution.

Much weaker loan growth: Bank lending conditions indicate to us that loan growth will fall to 4% in Europe and -6% in the US over the next 12 months. Banks typically trough six months before the trough in loan growth and that looks a long way out.

Finally, government intervention: the risk of governments' forcing banks to lend on unfavourable terms (or risk nationalisation) is very high.

We would only focus on lowly leveraged banks (as they can cherry pick assets, exploit the increase in NIMs and have less need for government money) in lowly leveraged countries (ie, countries where private sector leverage and financial product penetration are low). The ideal combination is hard to find but the best-ranked banks in the best-ranked countries on our screens are: Intesa, Alpha, KBC, ICBC, UOB and Resona. Societe Generale has one of the highest correlations with credit spreads and France ranks well on our country screen.

Japanese banks rank well from a risk/reward point of view. If credit spreads rise, they will outperform as Japanese banks, corporates and consumers have well below average leverage. Japan is also the world's biggest net creditor (with net foreign assets being nearly half of GDP). If, however, GDP growth recovers and bond yields rise, Japanese banks should also outperform (given their strong positive correlation with bond yields). They trade on global peer averages on pre-provisioning profits. We suspect that the Yen will be the strongest currency in 2009.

Global focus list

We would highlight the following list of Outperform-rated stocks that fit into our preferred sectors and themes: Danone, Ahold, BAE, Vinci, Deutsche Telekom, Aegon, Swiss Re, TNT, Cardinal Health, AGCO Corp, Quanta Service, Nucor, Public Services Ent. Group, Qualcom, HTC, Sumitomo Mitsui Financial Group, Resona, ICBC, Sun Hung Kai.

Thematic baskets

Credit Suisse Delta One has created two baskets based on our preferred themes: high dividend yield (Bloomberg code: CSGLHDYD) and 'masters of their own destiny' (Bloomberg code: CSGLDEST). Please contact our Delta One sales team for more information.

Sector weightings

Figure 1: European sector recommendations

	Over/underweighting score	Benchmark weight (a)	Recommended weight (b)	difference from benchmark (bps) (b-a)	difference rel to sector (% pt) (b/a)	Change (bps)
Insurance	**1.35**	6.6	9.0	232	35	10
Diversfied telecoms	**1.32**	8.2	10.9	263	32	
Wireless telecoms	**1.32**	0.2	0.2	5	32	
Tobacco	**1.20**	0.1	0.1	2	20	
Technology Hardware & Equipment	**1.15**	2.7	3.1	40	15	
Software & Services	**1.15**	1.2	1.4	19	15	15
Beverages	**1.15**	1.0	1.2	16	15	
Semiconductors & Semiconductor Equipment	**1.15**	0.4	0.4	5	15	15
Pharmaceuticals & Biotechnology	**1.10**	10.6	11.6	106	10	
Food & Staples Retailing	**1.05**	6.2	6.5	31	5	-15
Diversified Financials	**1.05**	4.7	4.9	24	5	
Consumer Durables & Apparel	**1.00**	1.7	1.7	0		
Food Products	**1.00**	1.7	1.7	0		
Health Care Equipment & Services	**1.00**	1.3	1.3	0		
Household & Personal Products	**1.00**	1.0	1.0	0		
Real Estate	**1.00**	0.5	0.5	0		
Pulp & paper	**1.00**	0.5	0.5	0		
Banks	**0.97**	10.8	10.5	-32	-3	2
Metals & Mining	**0.95**	1.3	1.2	-6	-5	
Retailing	**0.95**	1.0	0.9	-5	-5	5
Utilities	**0.90**	8.5	7.7	-85	-10	-5
Energy	**0.90**	7.4	6.6	-74	-10	-10
Chemicals	**0.90**	3.6	3.3	-36	-10	
Construction Materials	**0.90**	1.1	1.0	-11	-10	
Commercial Services & Supplies	**0.90**	0.5	0.4	-5	-10	
Automobiles & Components	**0.80**	3.6	2.8	-71	-20	10
Media	**0.80**	2.2	1.8	-45	-20	
Capital Goods	**0.70**	9.0	6.3	-270	-30	
Transportation	**0.70**	1.8	1.2	-53	-30	-15
Hotels & Leisure	**0.70**	0.7	0.5	-21	-30	
		100	**100**			

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Figure 2: Global sector recommendations

	Over/underweighting score	Benchmark weight (a)	Recommended weight (b)	difference from benchmark (bps) (b-a)	difference rel to sector (% pt) (b/a)
Insurance	**1.35**	4.4	5.9	153	35
Diversfied telecoms	**1.35**	3.9	5.3	137	35
Wireless telecoms	**1.35**	1.3	1.7	45	35
Tobacco	**1.20**	1.4	1.7	28	20
Pharmaceuticals & Biotechnology	**1.15**	9.1	10.5	136	15
Health Care Equipment & Services	**1.15**	2.5	2.9	38	15
Technology Hardware & Equipment	**1.10**	5.2	5.7	52	10
Software & Services	**1.10**	4.0	4.4	40	10
Beverages	**1.10**	2.0	2.1	20	10
Semiconductors & Semiconductor Equipment	**1.10**	1.3	1.4	13	10
Diversified Financials	**1.05**	4.4	4.7	22	5
Consumer Durables & Apparel	**1.05**	1.3	1.4	7	5
Food Products	**1.00**	2.8	2.8	0	
Food & Staples Retailing	**1.00**	2.7	2.7	0	
Household & Personal Products	**1.00**	2.1	2.1	0	
Real Estate	**1.00**	1.9	1.9	0	
Pulp & paper	**1.00**	0.3	0.3	0	
Banks	**0.98**	7.8	7.6	-16	-2
Metals & Mining	**0.95**	2.8	2.6	-14	-5
Retailing	**0.95**	2.1	2.0	-10	-5
Energy	**0.90**	12.1	10.9	-121	-10
Utilities	**0.90**	5.6	5.0	-56	-10
Commercial Services & Supplies	**0.90**	0.8	0.7	-8	-10
Chemicals	**0.80**	2.4	1.9	-48	-20
Media	**0.80**	2.3	1.8	-45	-20
Construction Materials	**0.80**	0.3	0.3	-7	-20
Capital Goods	**0.70**	7.7	5.4	-232	-30
Transportation	**0.70**	2.3	1.6	-68	-30
Automobiles & Components	**0.70**	2.0	1.4	-61	-30
Hotels & Leisure	**0.70**	1.3	0.9	-38	-30
		100	**100**		

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Themes for 2009 and beyond!

We believe that an understanding of longer-term trends is critical in this macro-driven environment.

We focus on seven themes:

(1) Credit looks very attractive—we show how to play it via equities.

(2) We think **the outlook for corporate discretionary spending remains bleak.**

(3) 'Masters of their own destiny': we believe low-leverage large-cap companies with high cash flows and low historical cash-flow volatility should outperform in the current environment.

(4) NJA will drive global growth – and we highlight possible ways to play this theme.

(5) Infrastructure plays, we believe, should benefit from governments' fiscal stimulus packages**.**

(6) Short asset-life industries should do well in a deflationary environment

(7) Buy high dividend yield and big caps... avoid low FCF and high leverage, but mild leverage could outperform.

(1) Credit offers great value—add beta in equities via credit plays

Credit offers great value

The five-year cumulative default rate for US speculative debt implied by the CDS spreads is now higher than the default rates experienced during the 1930s.

Figure 3: **The CDX high-yield index stands at around 1,400**

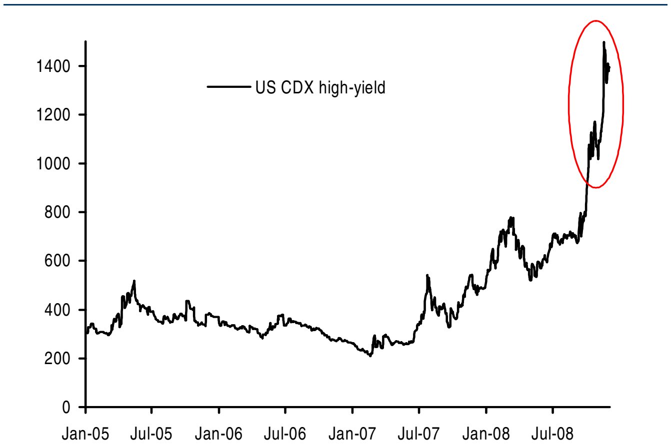

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Figure 4: **If we assume a risk premium of 200bps and a recovery rate of 40%, this gives us an implied five-year cumulative default rate of 64%**

		Risk premium			
		100	200	300	400
Recovery rate	10%	52%	49%	46%	43%
	20%	56%	53%	50%	47%
	30%	61%	58%	55%	52%
	40%	67%	64%	61%	57%

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The CDX high-yield index stands at around 1,400. If we assume a recovery rate of 40% (the long-run average), the implied default rate is 64%. Even if we assume a more pessimistic recovery rate of 20%, the implied default rate is still 47%, compared with the 1930s when the peak default rate was 46%.

Figure 5: The credit default swap market is pricing in an all-time high default rate

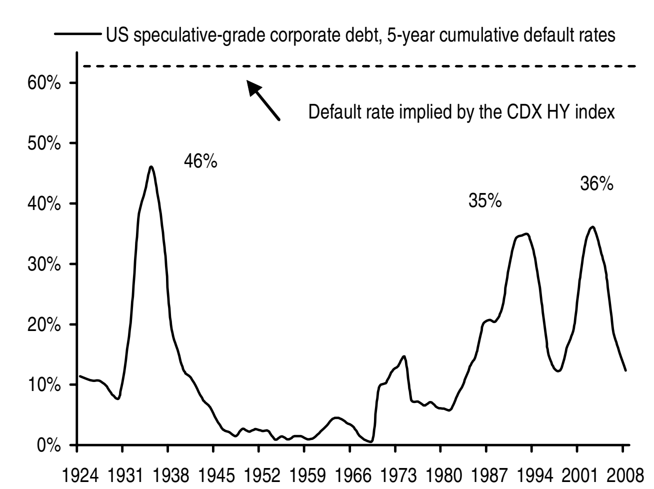

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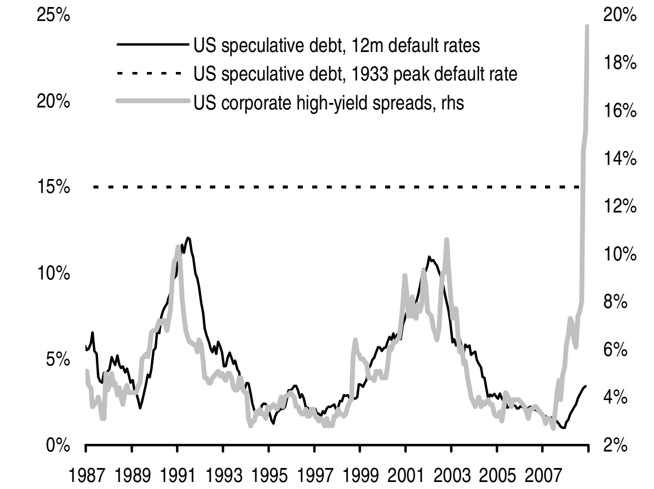
Figure 6: US HY spreads imply a 12m default rate far above the 1930s peak levels



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We also look at the empirical relationship between high-yield spreads and speculative grade defaults (Figure 6). The current level of bond spreads (19.8%) is consistent with a default rate of 24% over the next 12 months—this is more than seven times the current level of 3.4%. In comparison, the historical peak in the actual 12-month trailing default rate was 15% in 1933 and Moody's default forecast for high yield default is 11.4% over the next 12 months. The long-run average is 4%.

It is very hard to imagine this is a similar environment to the 1930s: nominal GDP fell 50%, real GDP by 27%, consumer prices fell by 23% between 1929 and 1933 and the unemployment rate peaked at 25%. At the start of the depression, interest rates were raised, taxes were raised, there was a trade war and underperforming banks were allowed to fail. This time, the starting position for corporates was actually better than at the beginning of past crises in terms of leverage and free cash flow, as we show in Figure 7 and Figure 8.

Figure 7: US FCF/GDP ratio still above average

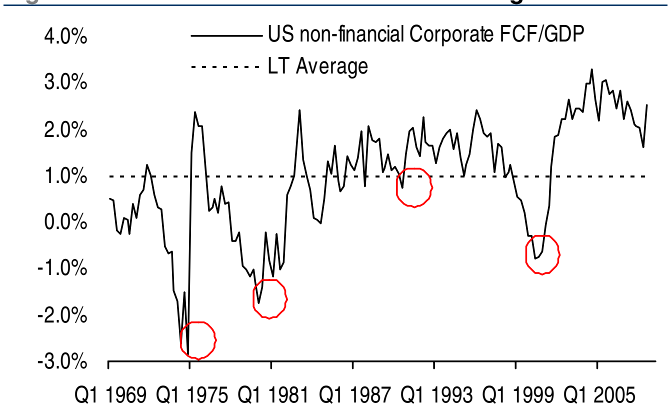

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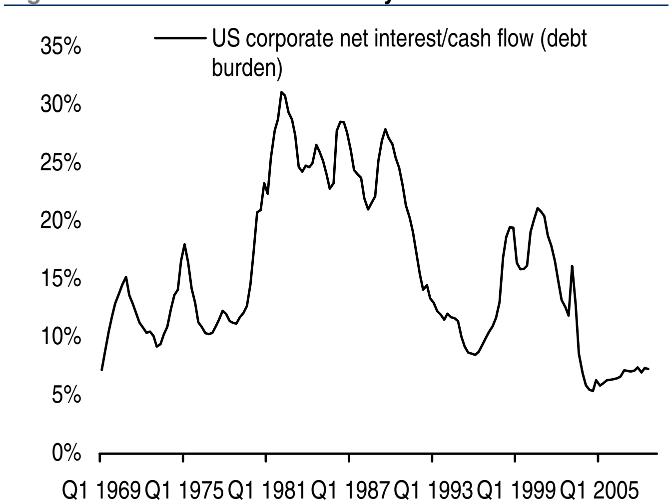
Figure 8: US debt burden still very low



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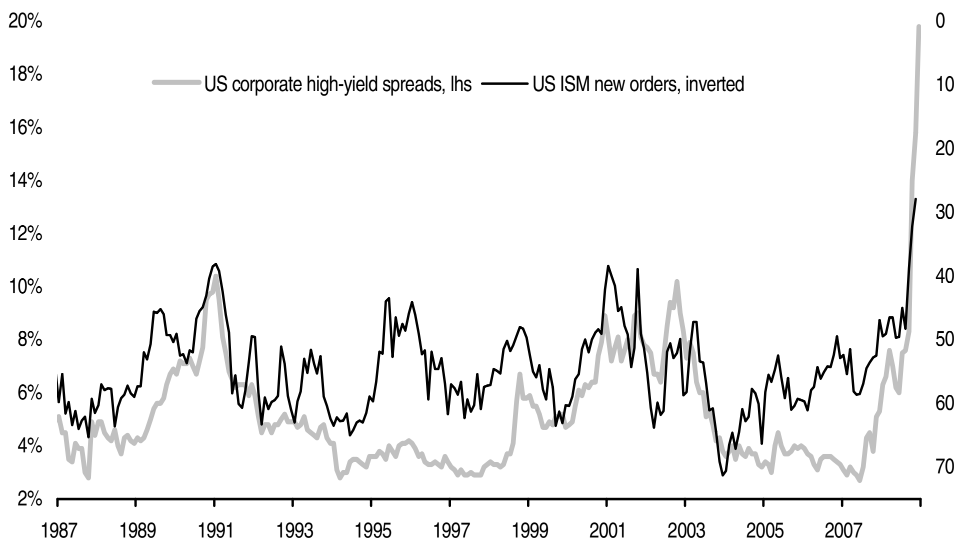
Credit offers better value than equities:

We think credit is more attractive than equities for two reasons.

1) **The level of economic activity implied by credit spreads is extremely low**: Historically, there has been a close fit between credit spreads and economic activity (as measured by ISM new orders). The series fell to a 30-year low of 27.9 in November. Yet, the current level of credit spreads is consistent with ISM new orders falling to close to zero (Figure 9), implying a 8% fall in GDP.

Figure 9: **Credit spreads imply an implausibly low level of economic activity**



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This would take roughly 35–40% off our US$70 operating EPS estimate for the S&P 500 (I/B/E/S consensus for 2009 is US$76), taking earnings down to around US$45–$50. If the credit market is right and we are in a 1930s-style scenario, we would be likely to see a period of sustained deflation. In the past, deflation has been associated with an average multiple of 12, implying around 550 on the S&P500.

2) **We believe equities will not rally without a rally in credit**

We believe that for a sustained rally in equities we need to see a significant improvement in credit conditions. Credit spreads and equities have been very closely correlated over the past six months (Figure 10).

In this crisis, credit is clearly the main constraint: short-term provision of credit—vital for funding working capital and trade flows—has practically dried up and credit spreads determine financial institutions' write-offs as well as the cost of capital.

Figure 10: Over the past six months, credit and equities have moved in line

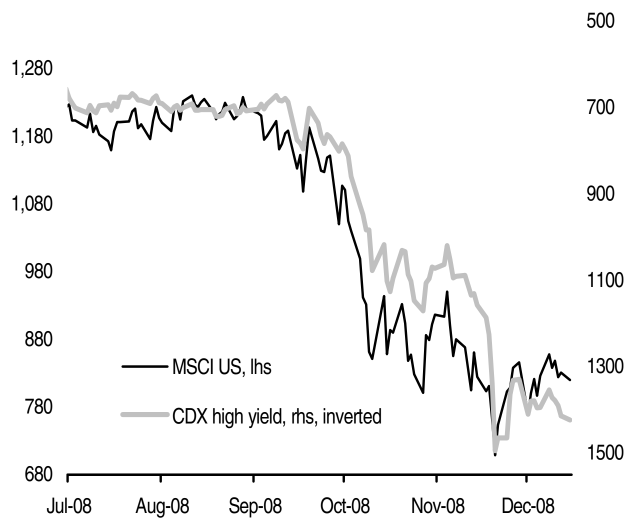

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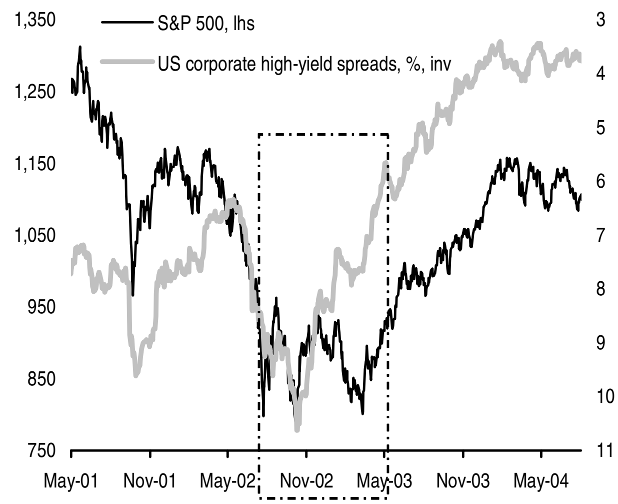
Figure 11: At the last market trough in 2002/03, credit rallied before equities



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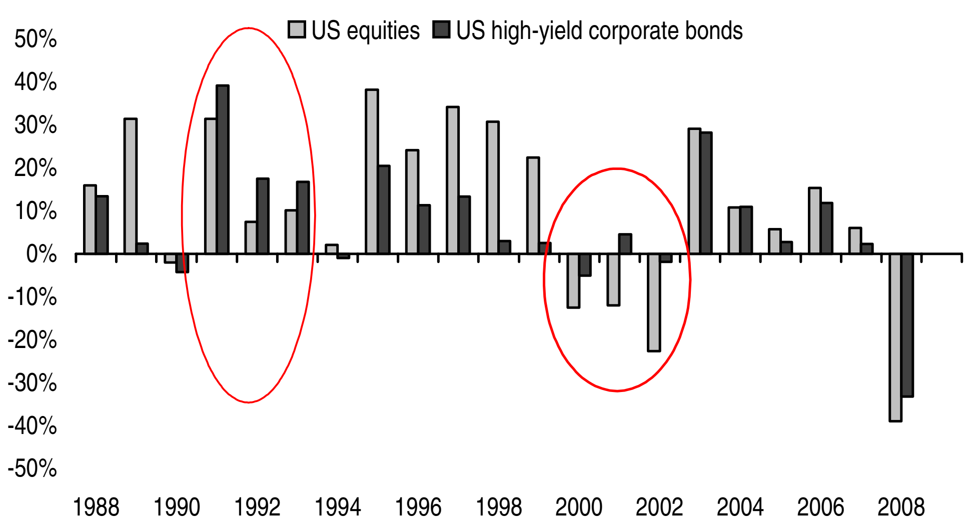
We would also highlight that during the trough in the last bear market in 2002/03, credit started to rally before equities. Credit troughed in October 2002, giving a clear signal that the downturn was over, while equities did not recover until March 2003 (Figure 11).

In the past two recessions, credit outperformed equities.

Figure 12: Credit outperformed equities during the past two recessions



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How to play credit in the equity market?

Below we outline what we consider to be the best credit plays within the equity market.

(a) Buy companies with high leverage but also have high FCF (thus funding issues can be avoided) and relative non-cyclicality (thus limiting the macro risk). We define non-cyclical stocks and sectors as those companies or sectors that have a negative correlation with lead indicators.

Figure 13: European non-cyclical companies with Investment grade S&P credit rating, high leverage and high FCF

			-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	Net Debt as a % of Mcap	S&P Credit Rating	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Vodafone Group	50%	A-	9.4	79%	-15%	0.9	-75%	12.9%	5.9%	-4.6	10.2	7.0	-1.1	-0.1	0.2	0.2	1.0	9.1	8.0	Neutral
Bt Group	124%	BBB+	6.9	67%	-10%	2.2	30%	10.0%	8.9%	-0.1	6.1	6.0	-0.3	-2.5	-11.1	0.7	0.5	-51.7	7.5	Neutral
France Telecom	100%	A-	9.5	92%	14%	1.8	1%	12.1%	7.2%	-0.9	15.9	5.0	0.4	0.3	0.8	0.0	1.5	13.5	6.5	Neutral
Teliasonera Ab	52%	A-	8.6	83%	-14%	1.6	56%	9.6%	5.1%	-1.4	18.3	5.0	-0.3	0.4	1.6	0.1	1.5	10.3	6.5	Neutral
Fortum Oyj	64%	A-	7.8	66%	0%	1.7	110%	9.8%	7.3%	-1.3	36.3	5.0	0.0	-0.4	2.2	2.2	1.5	0.0	6.5	Neutral
Repsol Ypf Sa	98%	BBB	6.8	77%	8%	1.0	-18%	10.4%	7.3%	-1.6	29.0	6.0	-0.4	-2.2	-5.0	-3.5	0.0	11.1	6.0	Restricted
Deutsche Telekom	131%	BBB+	13.7	133%	17%	1.3	42%	15.1%	6.8%	0.6	2.7	3.0	0.4	1.4	0.7	0.1	2.0	-4.8	6.0	Outperform
Henkel Ag&Co. Kgaa	55%	A	10.3	74%	5%	1.8	8%	8.0%	2.4%	-1.2	3.5	4.0	-0.3	-1.0	-1.6	-0.1	0.0	-3.2	5.0	Neutral
Telekom Austria(Ta	101%	BBB+	9.7	94%	-34%	2.1	51%	13.5%	6.6%	3.0	-40.9	4.0	-0.6	2.5	1.7	-0.2	1.0	42.9	5.0	Neutral
Ahold(Kon)Nv	53%	BBB-	11.3	88%	26%	2.6	36%	7.3%	2.3%	4.0	-39.9	2.0	-0.8	1.9	4.4	1.3	1.5	31.4	3.5	Outperform
Telefonica Sa	79%	A-	9.2	89%	7%	4.2	216%	12.7%	6.0%	2.7	-14.7	2.0	1.2	0.4	0.0	-0.5	1.0	31.8	3.0	Outperform
Swisscom Ag	82%	A-	9.7	95%	10%	3.5	50%	11.0%	5.7%	2.6	-22.6	2.0	0.2	-1.5	-0.3	-0.2	0.5	9.1	2.5	Outperform
Kon Kpn Nv	71%	BBB+	11.3	110%	34%	4.9	255%	12.5%	5.5%	5.5	-48.6	1.0	-0.3	1.0	-2.7	0.3	1.0	58.8	2.0	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Figure 14: US non-cyclical companies with Investment grade S&P credit rating, high leverage and high FCF

			-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	Net Debt as a % of Mcap	S&P Credit Rating	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Conocophillips	61%	A	6.9	78%	-9%	0.8	-42%	17.5%	3.7%	-6.0	19.0	7.0	0.4	-2.6	-12.9	NM	0.7	-14.3	8.7	Neutral
Pepsi Bottling Group Inc	187%	A	7.7	60%	-23%	1.5	-31%	7.3%	3.5%	-1.5	25.8	7.0	0.1	-5.6	-4.8	-2.1	0.5	-12.5	8.5	Neutral
Centurytel Inc	135%	BBB-	7.9	76%	-25%	0.8	-4%	20.7%	6.7%	-0.4	17.3	7.0	0.9	-0.2	-0.5	0.0	0.5	16.7	7.5	Neutral
Smith International Inc	73%	BBB+	6.1	106%	-48%	1.5	-37%	9.3%	2.0%	-10.3	158.4	6.0	-0.3	-0.1	-1.0	3.6	0.5	-20.0	7.5	Outperform
Conagra Foods Inc	67%	BBB+	9.2	71%	-5%	1.3	-37%	7.3%	5.5%	2.4	-23.8	5.0	-0.7	-2.2	-3.8	2.4	0.5	-80.0	6.5	Neutral
Anadarko Petroleum Corp	104%	BBB-	15.0	170%	-1%	0.9	-38%	8.6%	1.6%	-1.1	5.4	5.0	1.4	-2.9	-15.4	-4.6	0.5	21.4	5.5	Outperform
Sara Lee Corp	64%	BBB+	10.1	78%	4%	2.3	-27%	14.4%	n/a	1.0	-31.8	4.0	0.8	0.0	0.0	0.0	0.5	-53.9	5.5	Neutral
Pepsiamericas Inc	108%	A	8.4	67%	n/a	1.1	n/a	8.3%	3.2%	1.3	-26.0	3.0	0.5	0.1	-0.3	-1.7	1.0	-20.0	5.0	Neutral
Public Service Entrp Grp	74%	BBB	9.1	91%	27%	1.9	75%	6.2%	4.7%	-1.2	3.0	4.0	0.6	0.0	-1.5	-1.0	0.5	0.0	4.5	Outperform
Coca-Cola Enterprises Inc	240%	A	8.1	64%	-58%	1.9	38%	14.1%	2.9%	1.2	-62.7	3.0	-1.3	-0.1	-10.0	-1.5	0.0	-73.3	4.0	Neutral
At&T Inc	66%	A	10.0	97%	11%	1.5	-12%	8.3%	5.5%	2.2	-10.1	3.0	0.4	-0.1	-4.8	-0.1	0.5	28.6	3.5	Neutral
Heinz (H J) Co	52%	BBB	12.1	93%	23%	5.6	55%	7.6%	4.7%	8.1	-46.9	3.0	1.5	-0.3	-0.7	-4.2	0.5	16.7	3.5	Outperform
Cvs Caremark Corp	56%	BBB+	10.3	80%	7%	1.2	-29%	6.5%	0.9%	2.5	-28.0	3.0	2.4	0.0	-1.0	-0.4	0.5	80.0	3.5	Outperform
Kraft Foods Inc	68%	A-	13.3	103%	27%	1.5	28%	6.0%	4.2%	7.4	-57.6	2.0	-0.2	-0.1	-1.0	-1.8	0.0	-29.4	3.0	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Some investors, recalling 2003 when low FCF and highly leveraged companies outperformed the so-called 'low-quality' rally, might believe that if credit spreads fall we should be buying the very high-beta low-quality cyclicals. We disagree. In 2003, there was a very sharp upturn in growth and a massive collapse in spreads. Although we believe spreads will fall, a strong upturn in growth is highly unlikely, in our view.

If we were to buy cyclicals, we would look to companies with medium leverage that we think will survive.

Therefore we look for companies with net debt to market cap above 50% but below 100%, a FCF yield above 5%, a CDS spread below 200bp and a P/B relative below its norm. These are companies that should survive but are clearly cyclical.

Figure 15: European and US stocks with net debt as % of market cap between 50% and 100%, that have a FCF yield above 5%, with a CDS spread below 200bp and that are trading on a P/B relative below its historical norm

			-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT		--- Momentum --				
Name	CDS Spread	Net Debt as a % of Mcap	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Price, % change to best	Valuation score	3m EPS	3m Sales	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Koninklijke Dsm Nv	133	69%	5.5	62%	-1%	0.5	-15%	25.8%	7.7%	92.1	7.0	4.3	0.3	-15.8	10.0	Outperform
Conocophillips	123	61%	6.9	78%	-9%	0.8	-42%	17.5%	3.7%	19.0	7.0	-12.9	NM	-14.3	8.7	Neutral
Northrop Grumman Corp	85	73%	7.8	93%	5%	0.8	-17%	13.1%	3.9%	2.4	6.0	1.1	0.6	-10.0	8.5	Outperform
Vodafone Group	198	50%	9.4	79%	-15%	0.9	-75%	12.9%	5.9%	10.2	7.0	0.2	0.2	9.1	8.0	Neutral
Securitas	148	82%	9.5	80%	-10%	2.6	-3%	9.6%	4.6%	-55.0	5.0	4.1	2.0	-17.7	7.5	NR
Hospira Inc	102	52%	10.1	82%	-18%	2.4	-14%	9.1%	n/a	-8.9	5.0	0.1	NM	-20.0	7.3	NR
News Corp	177	71%	7.8	73%	-25%	0.8	-32%	13.3%	n/a	-1.1	5.0	0.0	0.0	-4.4	6.5	Neutral
Conagra Foods Inc	96	67%	9.2	71%	-5%	1.3	-37%	7.3%	5.5%	-23.8	5.0	-3.8	2.4	-80.0	6.5	Neutral
Dover Corp	141	53%	9.1	107%	-9%	1.4	-32%	13.9%	3.1%	46.8	5.0	-1.0	-1.3	-11.1	6.5	NR
Stanley Works	151	87%	9.1	63%	7%	1.4	-27%	15.3%	3.8%	-10.7	5.0	-4.6	-1.4	-75.0	6.0	NR
Lvmh Moet Hennessy	180	67%	10.7	94%	-3%	2.1	-1%	7.1%	3.5%	-40.3	5.0	-2.0	-0.1	58.6	5.5	Outperform
Sara Lee Corp	98	64%	10.1	78%	4%	2.3	-27%	14.4%	n/a	-31.8	4.0	0.0	0.0	-53.9	5.5	Neutral
Beckman Coulter Inc	160	65%	10.0	81%	11%	1.6	-6%	5.6%	n/a	-17.4	4.0	-1.0	-0.5	-9.1	5.5	NR
Newell Rubbermaid Inc	176	99%	8.6	59%	-15%	1.6	-26%	11.4%	n/a	-36.5	5.0	-4.1	-2.8	20.0	5.0	NR
Du Pont (E I) De Nemours	189	67%	11.4	130%	24%	1.9	-14%	11.5%	6.4%	-25.1	3.0	-16.5	-3.3	-17.7	4.0	Outperform
At&T Inc	199	66%	10.0	97%	11%	1.5	-12%	8.3%	5.5%	-10.1	3.0	-4.8	-0.1	28.6	3.5	NR
Cvs Caremark Corp	145	56%	10.3	80%	7%	1.2	-29%	6.5%	0.9%	-28.0	3.0	-1.0	-0.4	80.0	3.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

b) **Sector and stocks with a high correlation to credit**: In Europe, financials have the highest negative correlation with credit spreads (we look at the European Itraxx crossover index)—that is, they should outperform as spreads come down.

Figure 16: Financials have the highest negative correlation with credit spreads in Europe

Sector	Correlation coefficient
Diversified Financials	-0.55
Insurance	-0.47
Banks	-0.43
Capital Goods	-0.28
Real Estate	-0.25
Metals & Mining	-0.20
Consumer Durables	-0.16
Technology Hardware	-0.12
Semiconductors	-0.03
Construction Materials	-0.01
Hotels & Leisure	0.02
Automobiles	0.04
Retailing	0.05
Transport	0.07
Chemicals	0.09
Paper	0.10
Commercial Services	0.12
Software	0.20
Energy	0.24
Media	0.26
Utilities	0.27
Tobacco	0.30
Food Staples	0.32
Household Products	0.34
Beverages	0.34
Telecoms	0.35
Pharma	0.38
Food Products	0.40
Health Care	0.44

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In the US, insurance, diversified financials, autos, construction materials and insurance have the highest negative correlation with the CDX high-yield index (We show the US table in Appendix 5).

Unsurprisingly, financials also show the highest negative correlation with credit spreads on the stock level. Of the Credit-Suisse Outperform-rated names we highlight Societe Generale, BBVA and Aegon.

Figure 17: **Companies with the highest negative correlation to credit spreads**

Company	Sector	Correlation with iTraxx crossover	Credit Suisse rating
Societe Generale	Banks	-0.40	Outperform
Q-Cells (Xet)	Capital Goods	-0.39	Outperform
Bbv.Argentaria	Banks	-0.37	Outperform
Renewable Energy	Capital Goods	-0.36	Outperform
Acciona	Utilities	-0.33	Outperform
Aegon	Insurance	-0.33	Outperform
Kbc Group	Banks	-0.32	Outperform
Unicredit	Banks	-0.32	Outperform
Aviva	Insurance	-0.31	Outperform
Zurich Financial Svs.	Insurance	-0.31	Outperform

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In the US, the Outperform-rated stocks with a high correlation with credit spreads are: Invesco, Nordstrom and Ameriprise. (See Appendix 5 for the complete table).

c) European non-life insurers: They have large holdings in corporate bonds, as shown below, and thus should benefit from a rally in credit.

Figure 18: **European non-life insurers: Leverage to corporate bonds**

Company	Corporate bonds, % of total investments	Leverage to corporate bonds (% of embedded value)	Credit Suisse rating
Fondiaria - SAI	18%	243%	Neutral
RSA Insurance Group	35%	125%	Neutral
Zurich Financial Services	27%	101%	Outperform
Hannover Rueck	24%	101%	Neutral
Vienna Insurance Group	54%	77%	Outperform
Baloise-Holding	26%	75%	Neutral
Helvetia	28%	60%	Outperform
Scor Se	13%	55%	Outperform
Generali	26%	50%	Underperform
Allianz	28%	47%	Nr
Swiss Re	19%	44%	Outperform
Munich Re	4%	12%	Neutral

*Source: Company data, Credit Suisse European insurance research team; note: leverage to corporate bonds is calculated as: total corporate bond holdings * effective exposure of shareholders to these holdings * (1 – group tax rate) / embedded value; given the additional structured credit exposure of some companies, our table might understate their total credit leverage*

The European non-life insurers in Figure 18 are obvious beneficiaries of two trends:

a) Enforced capital discipline on the back of the dramatic contraction in the industry capital base as a result of falling asset values, accentuated by falling investment income and above-average loss experience in 2008. The problems at AIG should help other firms (Credit Suisse's insurance team reports that 71% of US brokers intend to get alternative quotes at renewal). Thus, if the financial crisis gets much worse, we would expect p&c and re-insurance premiums to be much more resilient than stock market earnings. The net impact of the financial crisis on p&c and reinsurance premiums could be similar to the aftermath of a big natural disaster (sucking capital out of the system and forcing up premiums) but with the scope for book value to come back unlike in the aftermath of natural disasters. Already we see anecdotal evidence of improvement: personal auto insurance is up 3.4% yoy in the US according to the latest CPI for insurance and the AA reports that in the UK auto premiums are up 5% yoy. According to Credit Suisse analysts, US catastrophe reinsurance could be up 20% and overall rates in Europe by 5% in 2009.

b) Claims frequency (particularly for motor lines, which account for c50% of p&c income) tends to improve when GDP growth slows or is negative. Reflecting these two trends, we can see that relative earnings momentum is now better than that of the market.

Figure 19: **European non-life insurance earnings momentum: Absolute and relative**

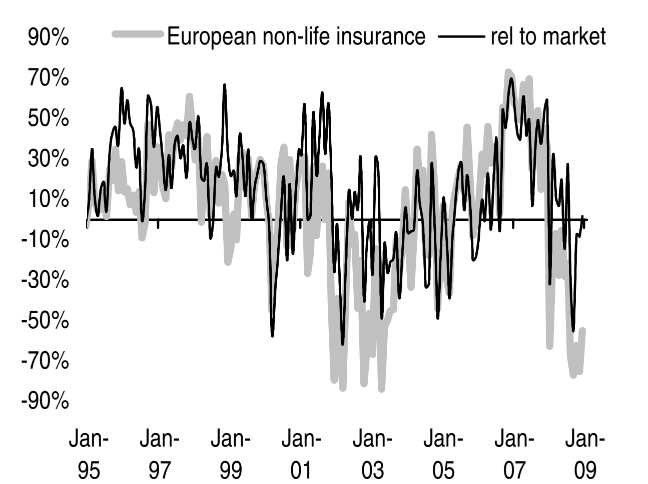

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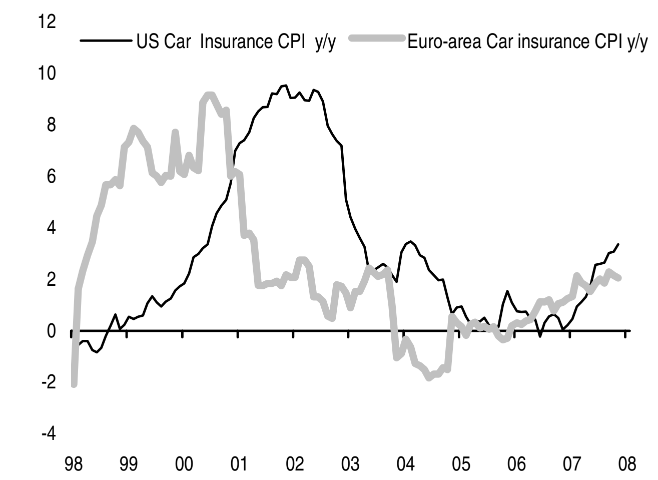
Figure 20: **Pricing for US and European insurers has improved**



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If we look at the valuation of non-life companies (the re-insurers), we find on P/E, P/B, DY and HOLT valuations that they are cheap relative to the market. Credit Suisse's European insurance team highlights ZFS and Swiss Re. The US team would highlight Ace and RenaissanceRe. The advantage of non-life companies is that embedded value methodology is less relevant and thus we can have more confidence in yield relatives.

Figure 21: Pan-Europe non-life insurers P/B rel non-financials

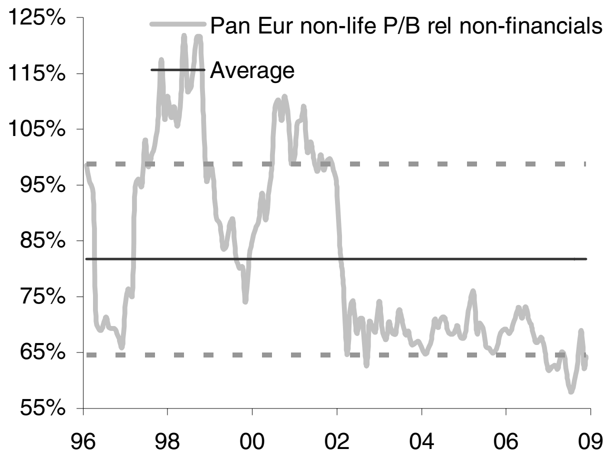

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Figure 22: Pan-Europe non-life insurers dividend yield rel to non-financials

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On Credit Suisse HOLT, European non-life insurers are only requiring below-average levels of profitability in order to be fair value relative to the market.

Figure 23: Pan Europe non-life insurers P/E rel to non-financials

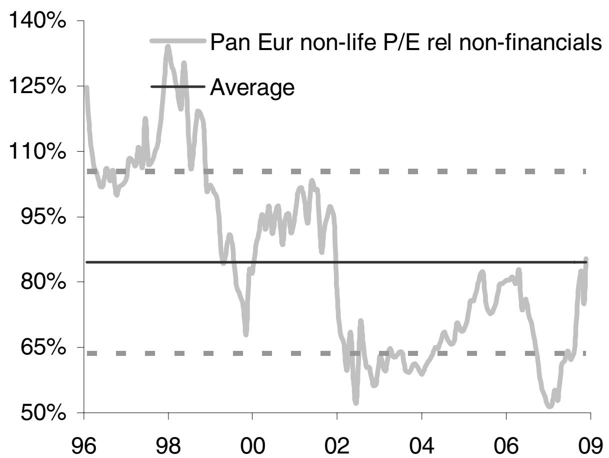

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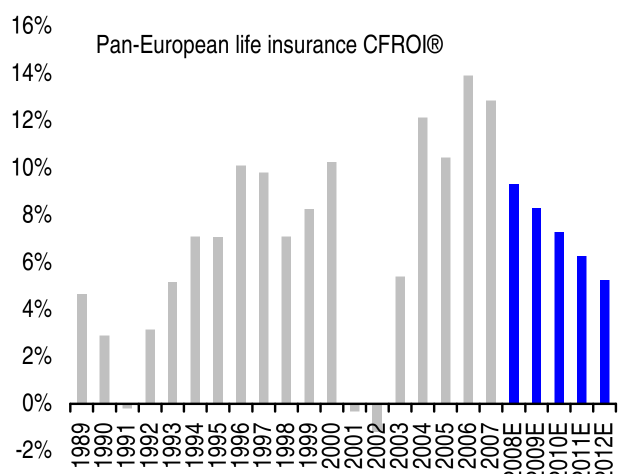
Figure 24: European non-life insurers look attractive on Credit Suisse HOLT



Source: Credit Suisse HOLT

Figure 25: European non-life insurers on HOLT: Model inputs and outputs

Sector name	CFROE®		Implied CFROE® fade (percentage points)	Model inputs			Historical average (10 years)	
	2008E	Required FY5		Length of fade (y)	Assumed RAGR	Real cost of capital	CFROE®	RAGR
European non-life insurers	9.3%	5.1%	4.2%	5	3.0%	6.0%	7.9%	7.7%

Source: Credit Suisse HOLT, Credit Suisse estimates

d) European life companies: These tend to have larger holdings of corporate bonds than non-life companies.

Figure 26: **European life insurers: Leverage to corporate bonds**

Company	Corporate bonds, % of total investments	Leverage to corporate bonds (% of embedded value)	Credit Suisse rating
Aegon	53%	277%	Outperform
Prudential	56%	179%	Neutral
Axa	38%	179%	Underperform
Aviva	28%	148%	Outperform
Legal & General	54%	144%	Neutral
ING Group	7%	135%	Outperform
CNP Assurances	36%	97%	Neutral
Standard Life	66%	96%	Underperform
Swiss Life Holding	31%	42%	Neutral
Friends Provident	48%	23%	Neutral

Source: Credit Suisse European insurance research team; note: given the additional structured credit exposure of some companies, our table might understate their total credit leverage

More importantly, they now look cheap both on traditional valuations and particularly on HOLT. Life companies in Europe have been even more heavily de-rated since 2000 than banks. Life companies in Europe now look cheap relative to US life companies.

Figure 27: **Pan-Euro life insurers P/B relative to banks**

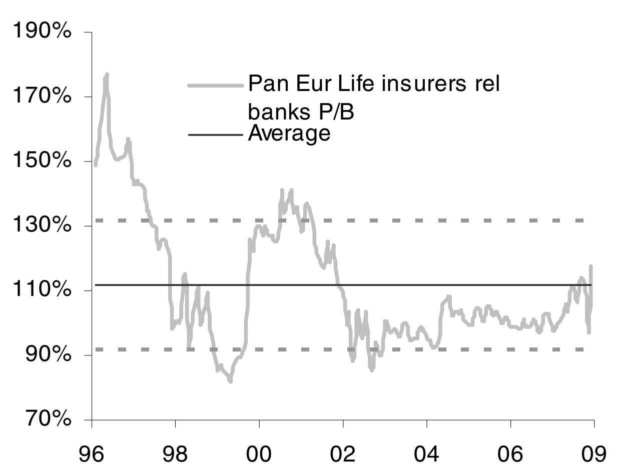


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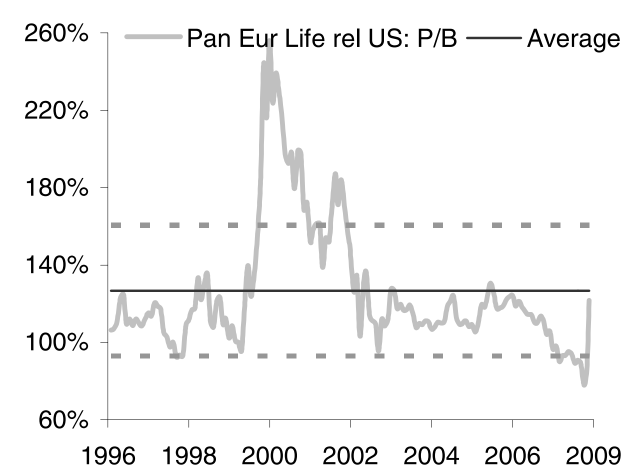
Figure 28: **Pan-Euro life rel to US life insurers P/B**



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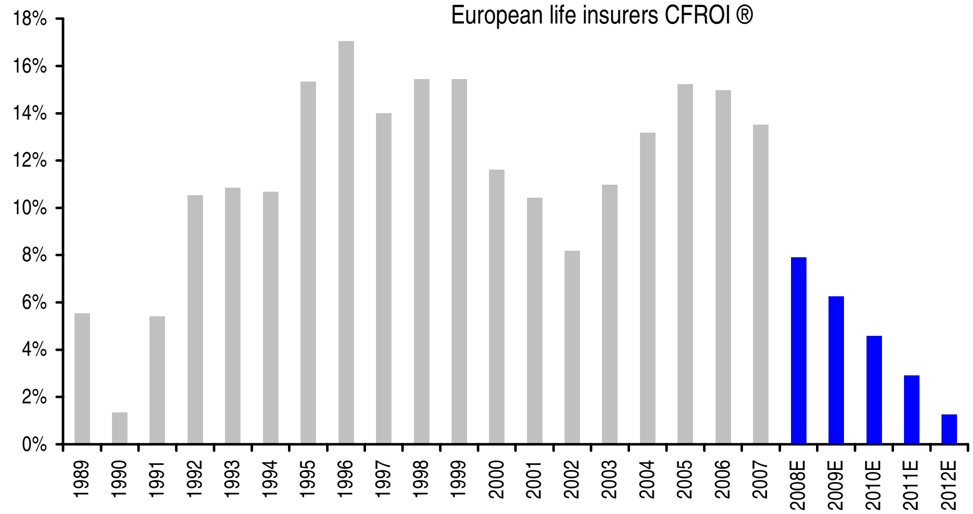
On HOLT, they are discounting trough levels of CFROE® (1.3%, compared with the current 7.9%).

Figure 29: **Pan-European life insurers require the lowest level profitability since 1990 in order to be fair value relative to the market**



Source: Credit Suisse HOLT, Credit Suisse estimates

Figure 30: **European life insurance on HOLT: Model inputs and outputs**

Sector name	CFROE®		Implied CFROE® fade (percentage points)	Model inputs			Historical average (10 years)	
	2008E	Required FY5		Length of fade (y)	Assumed RAGR	Real cost of capital	CFROE®	RAGR
European life insurers	7.9%	1.3%	6.7%	5	3.0%	6.0%	12.9%	10.4%

Source: Credit Suisse HOLT, Credit Suisse estimates

Life companies have underperformed banks by 60% since the peak in 1998. Yet, we believe that life companies have four advantages over banks:

a) They have suffered less reputational damage and are likely to be less strongly regulated into the upturn (ie, government may force banks to lend on uneconomic terms).

b) They have fewer liquidity problems than banks: Clients do not have the ability to call in their assets without penalties and, according to Credit Suisse's insurance team, there are relatively few refinancing needs over the next two years.

c) It is possible that because so many insurance companies faced substantial solvency issues in 2002 owing to asset/liability mismatches and guarantees, their management teams are better prepared into this downturn. Indeed it looks strange for insurance to be de-rated more than banks when European banks have had to raise €300bn of capital and life companies just €13bn.

d) There is still a long-term under-funding story for pensions in Continental Europe—however, retail will not seek to address this issue unless tax breaks become more favourable (which is unlikely as policies are likely to be promoted to boost investment or consumption as opposed to savings) or stocks markets/credit markets start to rise.

It is interesting to see that Resolution has raised money to buy closed-end policies in the UK once more. (In July 2007 the old Resolution was bid for on 1.25x embedded value.) This suggests that investors may be underestimating the value of the back book. Perhaps this environment is a catalyst to lower third-party commission fees?

Our top picks are Aegon, ING and Aviva in life companies and in the US Met Life and Ameriprise Financial.

e) **Credit-heavy fund managers**: In Europe, Credit Suisse analyst Dan Davies highlights Aberdeen (21% of assets under management related to corporate credit). In the US, Credit Suisse analyst Craig Siegenthaler points to Legg Mason (54% of AuM from fixed-income strategies) and Alliance Bernstein (38% of AuM from fixed-income strategies).

f) **Banks** have a strong negative correlation with credit spreads (Figure 16).

Not surprisingly, the most negatively correlated sector to credit is investment banks. However, a de-leveraged RoE of 12% has been the historical norm and the threat to the business model has been extreme and thus we are biased towards private banking-funded franchises where the price to book is below 1.5x. Perhaps the best credit play (and certainly the one with the highest correlation to credit on our estimates) is Societe Generale (it trades on 0.9x 2008E tangible book and generates 40% of its pre-tax profits from investment banking).

We have consistently highlighted the attractions of underleveraged banks in underleveraged countries. Our top picks are: Intesa, DnB, UOB , Resona, NBG (See page 148).

Figure 31: **Lowly leveraged European banks have outperformed highly leveraged ones over the past year**

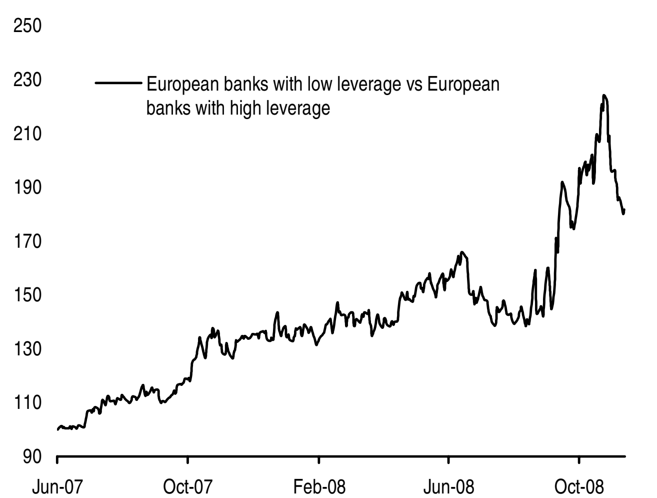


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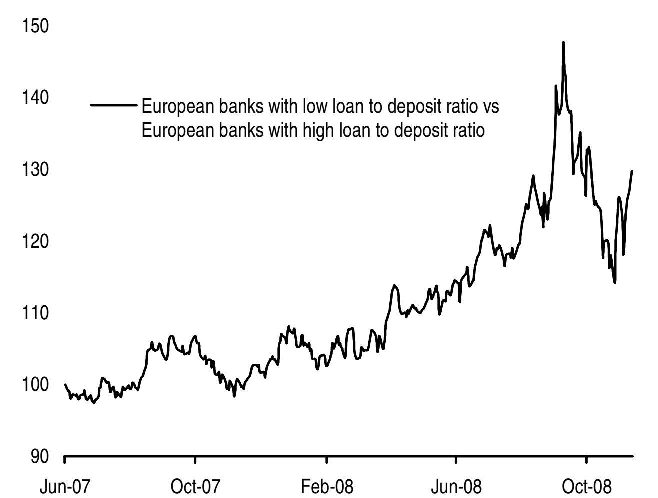
Figure 32: **European banks with low loan to deposit ratios have outperformed those with high loan to deposit ratios over the past year**



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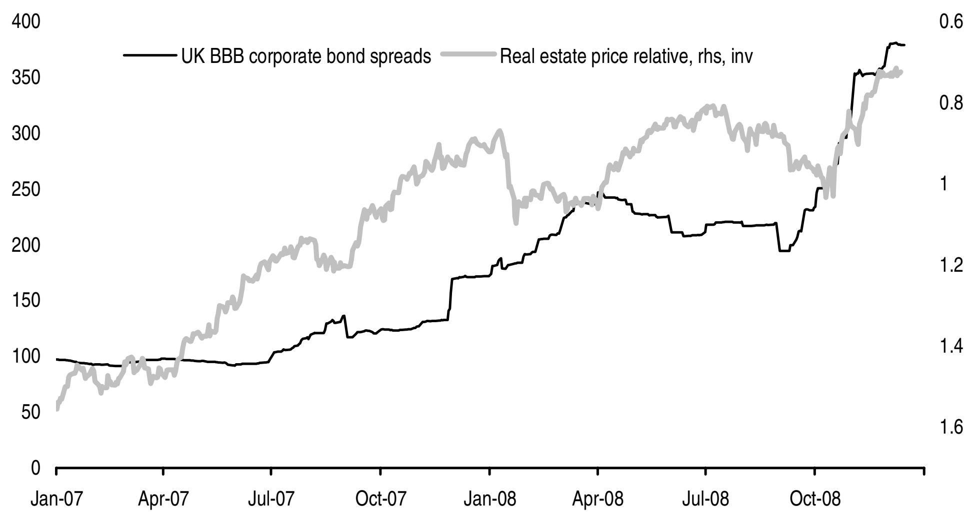
g) **Infrastructure**

We like infrastructure plays because their revenue will be supported by government policy) and, in the context of credit, their discount rate is linked to credit spreads. The most obvious beneficiary may be Vinci, with a 2008E FCF yield of 13% and an IRR of 15.8%.

h) UK real estate . . . we raised to benchmark in November

We lifted UK property to benchmark in November from underweight *(What to do with cyclicals?,* dated 12 November *2008).* The sector is our preferred play on falling UK interest rates and our preferred domestic UK sector (we remain underweight retail). Real estate has the fifth highest correlation with credit in Europe.

Figure 33: Relative performance of real estate versus UK BBB corporate bond spreads



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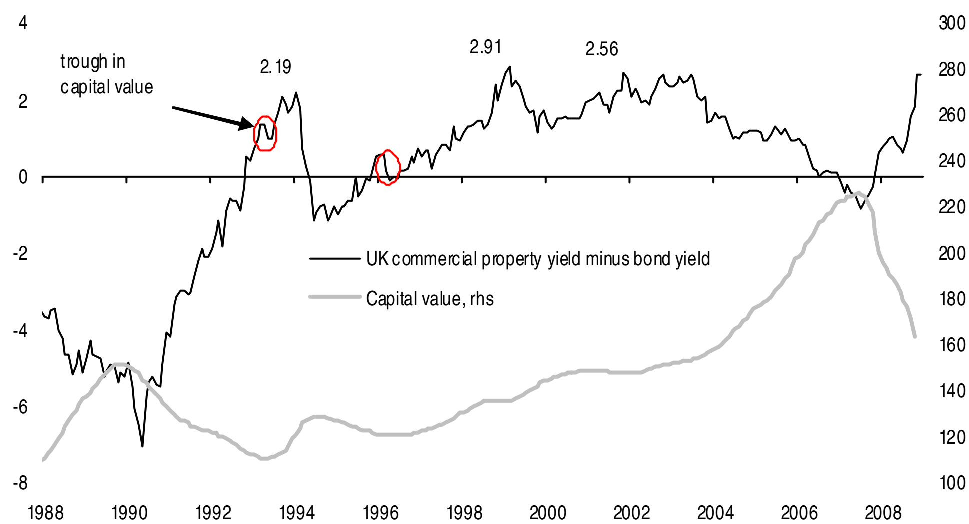
The rationale of lifting weightings was:

(a) At the trough of the cycle, we believe the property yield should be around 3% above the government bond yield, as has historically been the case at previous troughs.

Figure 34: Yield gap versus capital values



Source: IPD, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

This requires a property yield of around 7% (we use a target gilt yield of 4%). We then believe that rents will fall by about 20%, as they did in the early 1990s. This requires a initial property yield of around 8.5%.

To get a 8.5% rental yield, the discount to NAV needs to be about 43%.

We then believe that owing to leverage, a further 10% discount to NAV is required, hence we target a discount to NAV of around 53%. This is now roughly where we are.

The logic in our assumption that property yields need to be 3% above the bond yield is explained in Figure 35 and Figure 36: the cost of owning real estate is S,G and A, obsolescence and tenancy risk and the benefit is rental growth. The tenancy risk can be proxied by looking at corporate bond spreads (A-rated spreads are close to 300bps, but we assume these will come in by 50bps) and thus the property yield should be about 3.0% above the bond yield on this basis.

Figure 35: Methodology for required discount to NAV

Costs	
Tenancy risk (UK corp bond spread)	2.50
Obsolescence risk	0.50
S,G & A & stamp	1.50
Benefit	
Rental growth	1.50
Net costs	*3.00*
Target 10-yr gilt yield	4.00
Required property yield	7.00
Current initial yield	5.70
Discount to NAV	23%
Rents fall	20%
Deleveraging discount	10%
Total discount to NAV	**53%**

Source: Credit Suisse estimates

Figure 36: Peak to trough declines in capital values and rents

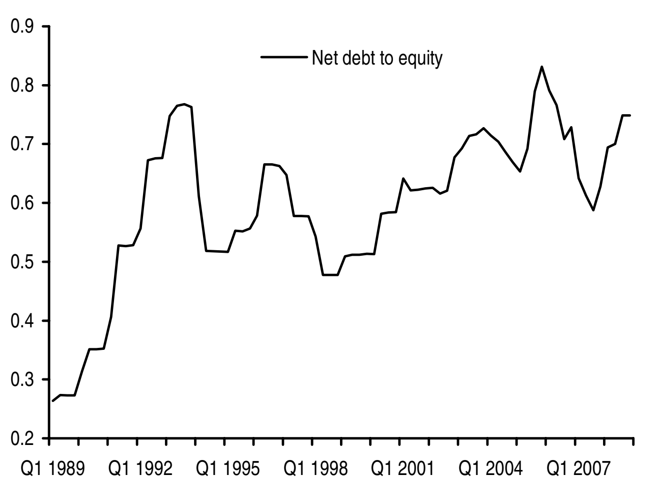
Capital value declines	**early 1990s**	**current**
Office	-38.4%	-27.7%
Industrial	-20.9%	-25.8%
Retail	-19.0%	-28.6%
Total	-27.1%	-27.5%

Rental declines	**early 1990s**	**current**
Office	-38.5%	-1.7%
Industrial	-22.5%	-0.3%
Retail	-7.0%	-0.3%
Total	-21.7%	-0.7%

Figures are national indices, we note London office rents have fallen 15% (City) and 5% (West End)

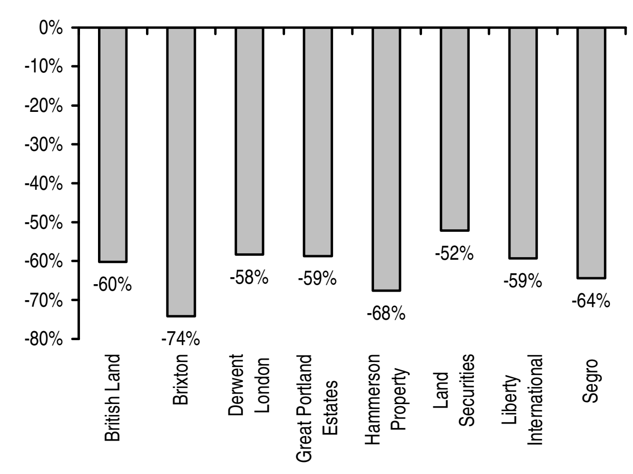
Source: Investment Property Databank, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 37: UK real estate net debt to equity



Source: Worldscope, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 38: UK property stocks are on a 55–60% discount to NAV on June 2008 reported NAV



Source: Credit Suisse real estate equities research

(b) On simple valuation measures property stocks are very cheap in the UK on P/B and P/E.

Figure 39: UK real estate is trading on a lower book multiple than in the early 1990s

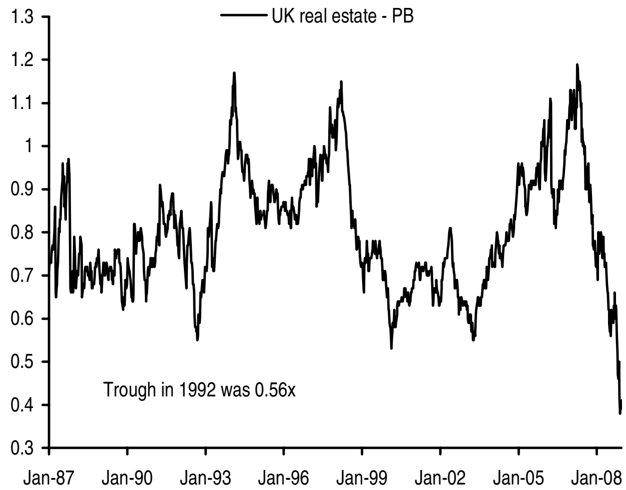


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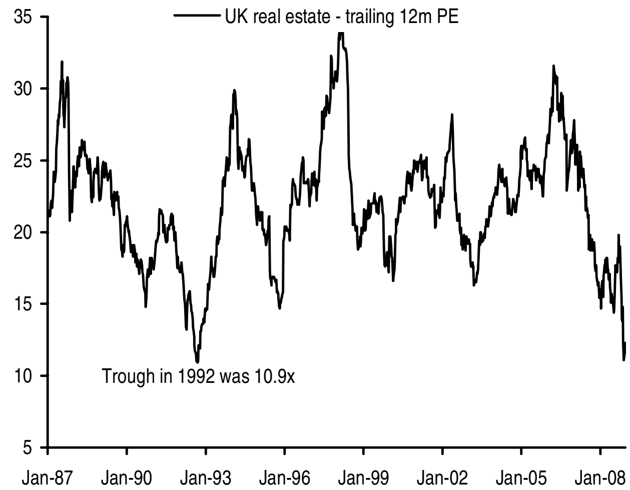
Figure 40: . . . and close to a trough multiple on P/E



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(c) UK property companies have underperformed those in the US by 25% over the past month.

Figure 41: UK and US real estate price relative to their own markets

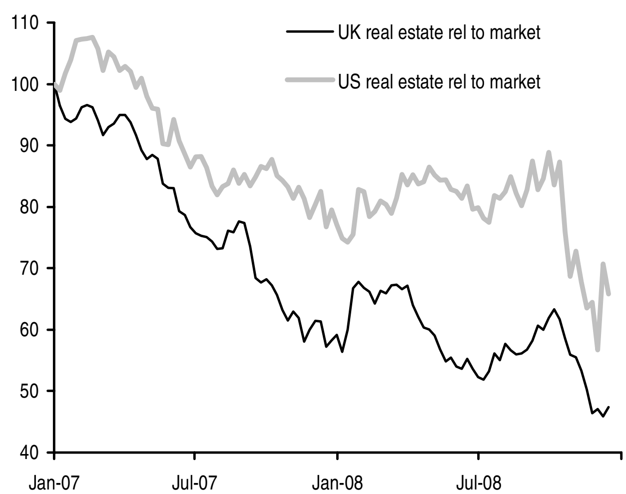

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Figure 42: UK real estate relative to US real estate

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(d) The chief concern we would have about this sector is leverage. However, according to Credit Suisse's analysts, many of the property companies have low LTV (circa 40–45%), high recourse to lending facilities and very long debt profiles (especially British Land).

Figure 43: Debt schedule of UK real estate companies (last reported)

Debt Schedule	British Land	Brixton	Great Portland Estates	Hammerson	Land Securities	Liberty International	Segro
Gross Debt (£m)	5000	858.8	429.3	3079.6	4632.5	3857.8	2395.1
Most recent undrawn credit facilities (£m)	2600.0	185.0	315.1	403.9	1481.0	360.2	536.2
Committed dev. costs	798.0	61.7	15.2	260.0	870.0	183.0	150.7
Net Amount	1802.0	123.3	299.9	143.9	611.0	177.2	385.5
Fixed	100%	87%	76%	57%	80%	100%	85%
Floating	-	13%	24%	43%	20%	-	15%
Weighted average cost of debt	5.30%	5.00%	6.01%	5.90%	5.30%	6%	5.50%
Maturity (Years)	12.9	5.5	8.0	8.0	10.7	6.4	9.6
Net Debt	4324	835.4	418	3006	6008	3740	2129.8
Debt							
Interest cover	**2.0x**	**1.8x**	**1.8x**	**1.71x**	**1.93x**	**1.53x**	**2.2x**
LTV	41%	37%	35%	41%	48%	42%	34%

Source: Credit Suisse real estate team research

Figure 44: UK real estate companies on our scorecard

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			-------- Momentum -----------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
British Land Co	10.6	n/a	-35%	0.4	-17%	n/m	6.7%	-0.7	27.8	7.0	0.8	-0.4	-0.8	-2.8	0.5	-22.2	8.5	Outperform
Great Portland Est	19.4	n/a	33%	0.4	-23%	n/m	5.1%	-2.2	36.2	5.0	1.1	3.3	5.4	0.1	2.0	-42.9	8.0	Underperform
Land Securities Gp	11.9	n/a	0%	0.5	-12%	n/m	6.8%	0.7	-24.6	2.0	-0.3	1.4	1.2	0.4	1.5	-55.6	4.5	Neutral
Liberty Int'L	16.9	n/a	15%	0.4	-26%	n/m	6.4%	2.5	-64.4	2.0	1.5	-3.3	-4.3	2.8	1.0	-88.9	4.0	Underperform
Shaftesbury	28.6	n/a	n/a	0.6	n/a	n/m	3.0%	4.0	-56.5	0.0	1.0	0.0	0.4	4.3	1.5	-40.0	2.5	NR

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

(2) The outlook for corporate discretionary spend remains very bleak

The best lead indicators of investment in the US suggest corporate spend could fall by around 15–20% over the next six months (compared with non-residential investment growth of -2%).

Figure 45: **ISM new orders point to a deceleration in business investment**

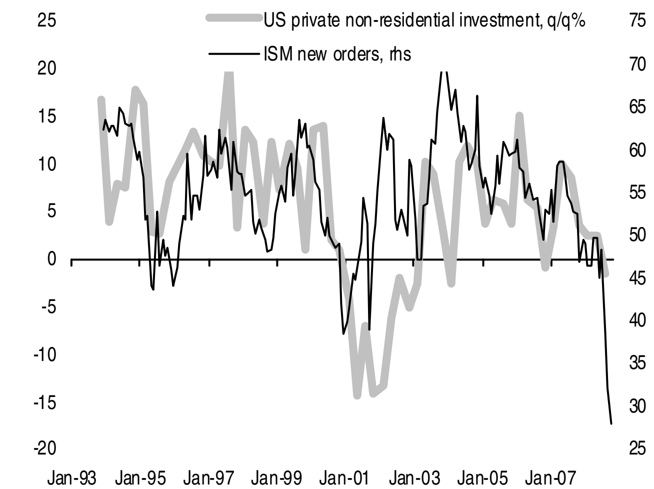

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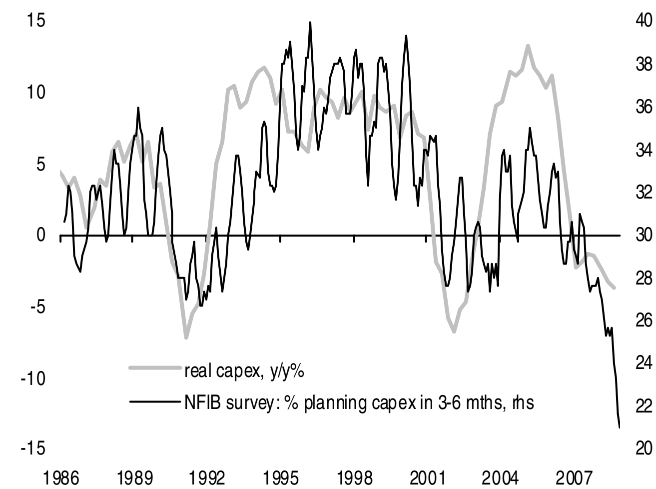
Figure 46: **NFIB survey also point to declining capex in the US**



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Normally capital spending has a beta of 2.3X to GDP but during a recession investment has a beta of 10X to consumption and a beta of 5X to GDP.

Figure 47: **Beta of real capex to GDP is 2.3**

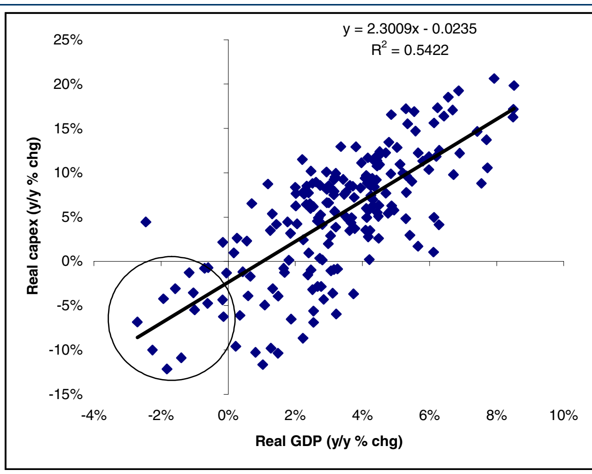

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Figure 48: **Into previous US recessions, investment has fallen 10x more than consumption**

US Recessions:		Peak-trough decline in:		
		Real GDP	Real Consumption	Real Investment
Q4 1973	Q2 1975	-2.4%	-1.8%	-18.5%
Q1 1980	Q3 1980	-2.2%	-2.4%	-10.0%
Q3 1981	Q4 1982	-2.6%	-0.8%	-9.5%
Q2 1990	Q1 1991	-1.3%	-1.1%	-9.5%
Q1 2001	Q3 2001	-0.4%	0.7%	-9.1%
Average		**-1.8%**	**-1.1%**	**-11.3%**

UK recessions

Peak to trough	GDP	Consumption	Investment
1990Q2-1991Q4	-2.5%	-3.3%	-12.2%
1979Q2-1981Q1	-5.9%	-3.5%	-16.3%
1973Q2-1975Q3	-3.3%	-3.3%	-6.6%
Average	-3.9%	-3.4%	-11.7%

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During the Great Depression capital spending fell in real terms by 81% as we can see from Figure 49 (and the investment share of GDP fell to a low of 3%). So clearly investment is the big loser into deflation!

Figure 49: Macro-economic variables during the Depression (1929–33)

real $bn	GDP	Consumption	Capex	CPI index	S&P EPS
1929	865.2	661.4	91.3	17.2	20.3
1930	790.7	626.1	60.9	16.7	13
1931	739.9	606.9	38.3	15.2	9.1
1932	643.7	553.0	11.5	13.1	6.8
1933	635.5	541.0	17.0	13.2	7.22
Peak-to-trough	**-27%**	**-18%**	**-81%**	**-23%**	**-67%**
YoY%	**GDP**	**Consumption**	**Capex**	**CPI index**	**S&P EPS**
1930	-8.6%	-5.3%	-33.3%	-2.9%	-36%
1931	-6.4%	-3.1%	-37.1%	-9.0%	-30%
1932	-13.0%	-8.9%	-70.0%	-13.8%	-25%
1933	-1.3%	-2.2%	47.8%	0.8%	6%
Average	**-7%**	**-5%**	**-23%**	**-6%**	**-21%**

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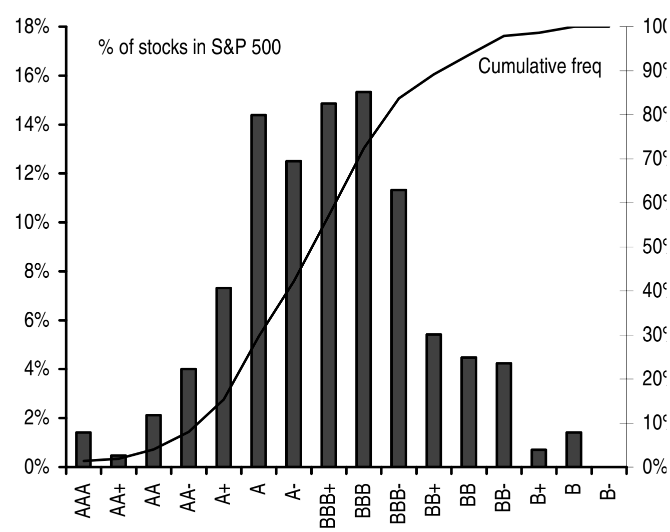
We would highlight that investment tends not to recover until GDP growth rises above 1.5–2%. We do not see this happening until at least 2010.

What really worries us is that any corporate today when deciding whether to invest or to allocate money elsewhere will be faced with the following conditions:

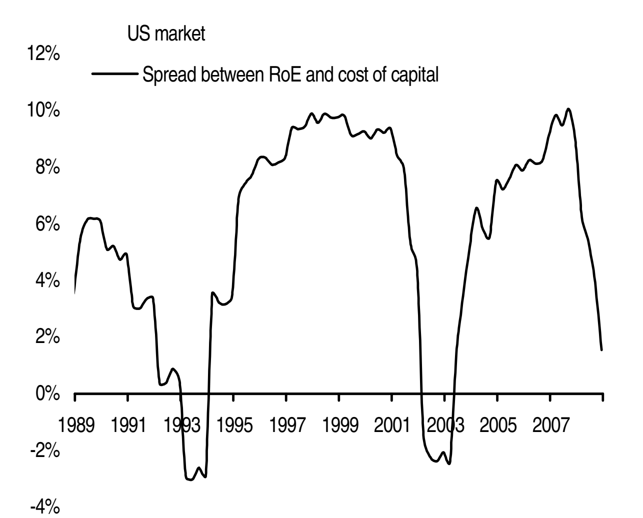
(1) The hurdle rate for any investment should have risen in line with corporate bond yields, especially for any sub-investment grade corporate. The median credit rating of the S&P 500 is BBB where the corporate bond yield is now 9.8%. Therefore, the spread between the return on equity and the cost of capital is close to zero.

Figure 50: The median credit rating of the US market is BBB



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse research. Note: Based on S&P 500 companies that have a credit rating

Figure 51: US market: RoE versus cost of capital



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Financing conditions are becoming worse and worse. In Figure 52 and Figure 53 we show the financing gap for US and European companies.

Figure 52: US corporate financing gap (FCF less dividends) is –2.3% of GDP

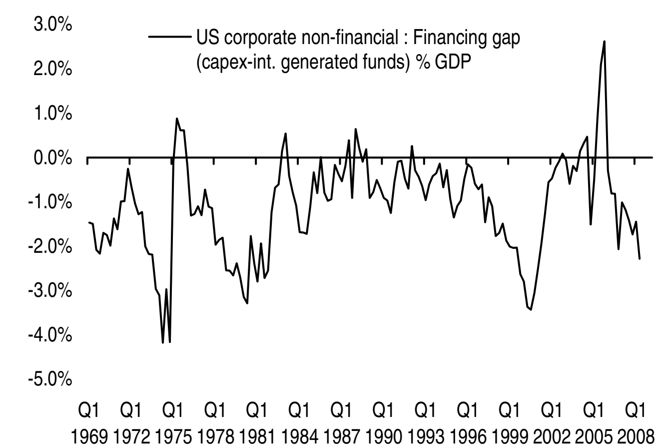

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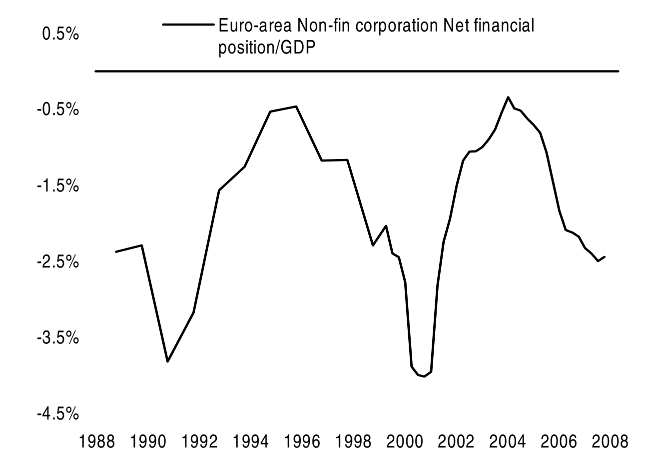
Figure 53: European companies are net borrowers to the tune of 2.4% of GDP



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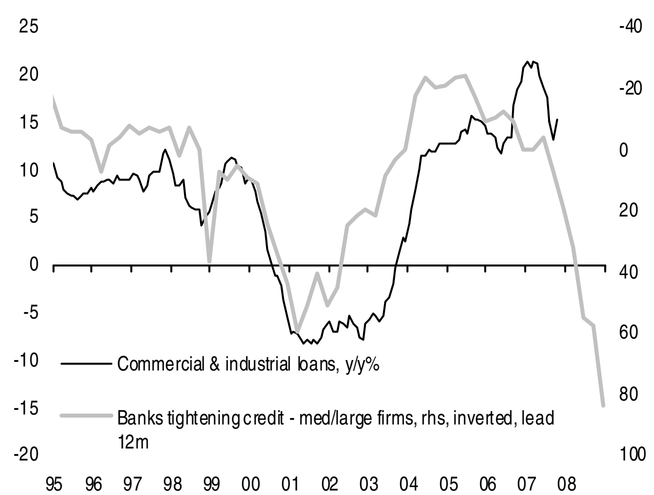
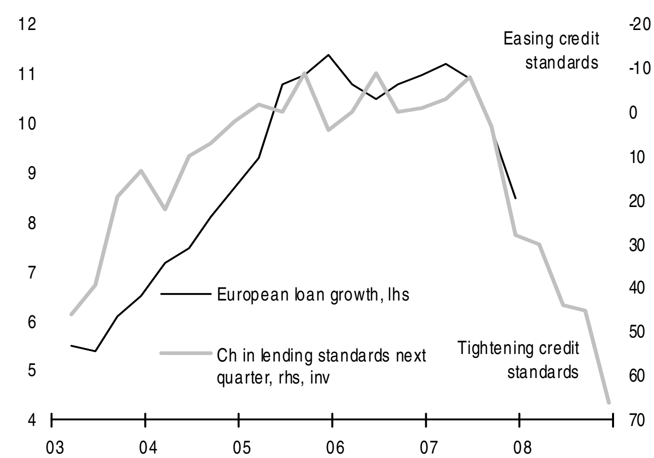
We also note that bank lending conditions remain very tight, suggesting that corporate and overall loan growth will slow sharply.

Figure 54: US lending standards to corporates and corporate credit growth



Source: Federal Reserve, Credit Suisse research

Figure 55: European lending standards to corporates (12m lead) versus European banks' loan growth



Source: ECB, © Datastream International Limited ALL RIGHTS RESERVED

(2) It is now much cheaper to buy in many sectors than to build assets. If we take the total stock market, 27% of market cap is trading below replacement value (and 41% of companies).

Figure 56: Value-to-cost for global sectors

Global Sector	% Companies below replacement value	% M cap below replacement value
Automobiles	85%	68%
Transportation	48%	44%
Met & Mining	61%	44%
Utilities	47%	43%
Materials	58%	42%
Chemicals	60%	38%
Cons Dur & App	38%	36%
Energy	43%	32%
Tech H/W	62%	25%
Telecoms	31%	23%
Capital Goods	35%	21%
Media	19%	18%
Cons Materials	36%	16%
Semis	41%	14%
Hotels & Leisure	17%	12%
Comm & Prof Svs	10%	10%
Retailing	17%	7%
Fd Bev & Tob	16%	5%
Fd & Spls Rtl	11%	3%
Pharmaceuticals	11%	3%
Healthcare	6%	2%
Software	2%	1%
H/H & Per Prod	0%	0%
Corp Disc Spending	24%	4%
Corp Disc Spending ex S/W	27%	7%
Global Market	41%	27%

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On HOLT, the whole market requires a CFROI® of 6.6%—using a 3% real asset growth rate and two-year fade horizon –, this is just marginally above the discount rate of 6%. Corporates contract if the anticipated CFROI® is below the discount rate.

(3) Volatility is close to an all-time high. High volatility is another way of expressing record uncertainty and as Keynes said 'animal spirits' are an important determinant of investment.

(4) Finally and perhaps most importantly, the global investment share of GDP has risen to an all-time high owing to the investment boom in the emerging markets. For this to normalise, we believe capex needs to fall by 15%.

Figure 57: Global investment share of GDP

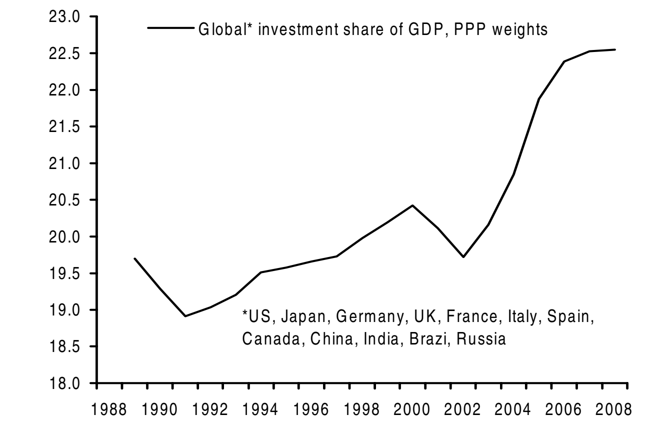

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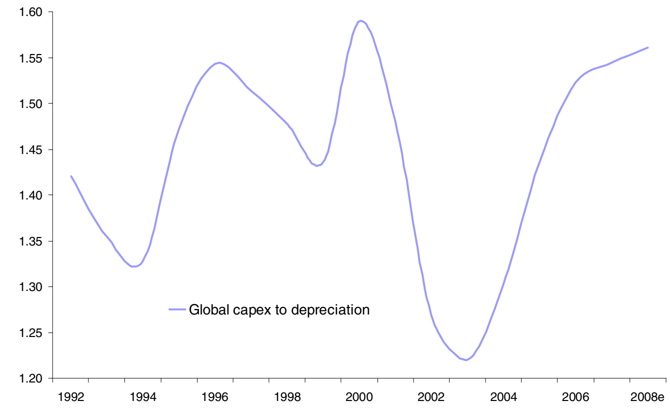
Figure 58: Global capital expenditure/depreciation



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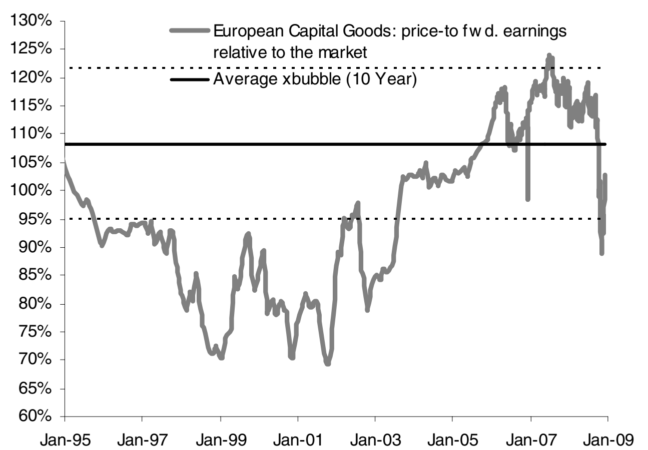
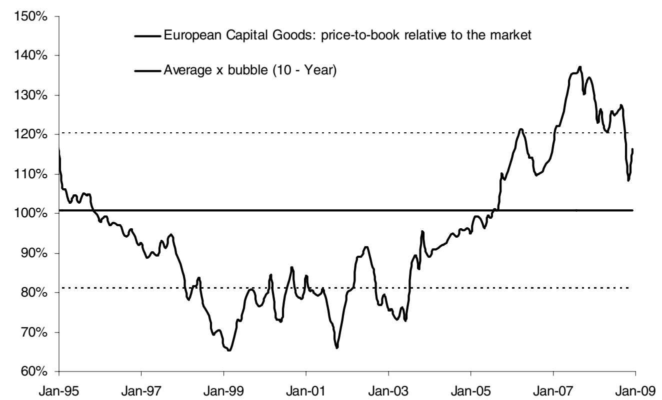
This keeps us structurally underweight capital goods companies, who curiously do not even look cheap on HOLT or on P/B relatives.

Figure 59: Capital goods are not back to their trough valuations on forward P/E relative to market



Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 60: Capital goods are trading slightly expensive on P/B



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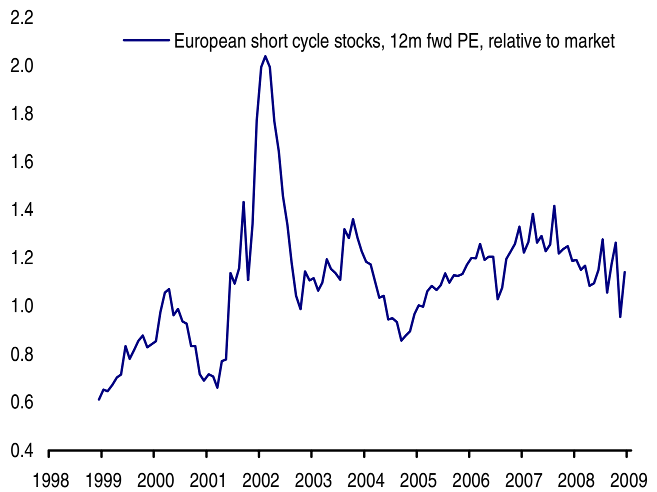
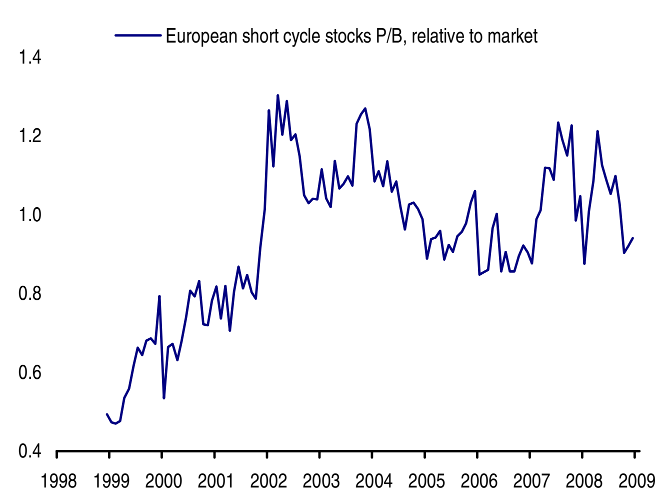
The same is true of the short-cycle capital goods stocks.

Figure 61: Short-cycle capital goods' forward P/E relative



Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 62: Short-cycle capital goods' P/B relative



Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

In Figure 63 we show capital goods companies with exposure to resources (of more than 10% of sales) that still trade on a P/B premium *or* are expensive on HOLT.

Figure 63: European capital good stocks with significant sales exposure to resources that still trade on a P/B premium or are expensive on HOLT

			-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	% sales exposure to resources (oil, gas and mining)	Net Debt as a % of Mcap	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Sandvik Ab	29%	66%	8.2	97%	2%	2.1	21%	9.9%	7.9%	-2.8	6.2	5.0	-1.6	-2.6	-6.0	-0.8	0.0	-40.7	6.0	Neutral
Atlas Copco Ab	22%	30%	9.4	110%	18%	5.2	227%	11.9%	5.1%	2.7	-10.2	2.0	4.3	-0.7	0.3	0.9	1.5	4.0	3.5	Underperform
Abb Ltd	21%	-4%	9.3	87%	-1%	2.8	23%	11.7%	3.8%	0.2	4.2	5.0	4.2	-0.2	-5.3	-2.5	0.5	-12.0	6.5	Underperform
Siemens Ag	10%	61%	8.7	90%	-8%	1.3	4%	7.7%	3.7%	3.4	-1.6	3.0	2.3	-0.5	-3.3	0.1	1.0	20.0	4.0	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

In Figure 64 we show European capital goods stocks that are more than 20% expensive on HOLT *and* trade above their P/B relatives:

Figure 64: European capital goods stocks that are more than 20% expensive on HOLT and trade above their P/B relatives

		-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	Net Debt as a % of Mcap	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Impregilo Spa	74%	7.5	79%	-7%	0.9	46%	-1.6%	0.8%	6.4	-25.9	2.0	-0.7	-2.1	-25.1	-2.4	0.0	77.8	2.0	NR
Bunzl	61%	11.2	269%	36%	4.0	85%	9.5%	3.4%	4.6	-33.9	1.0	1.8	0.0	0.2	0.7	1.5	53.9	2.5	NR
Nordex Ag	-36%	14.4	134%	-22%	2.1	263%	1.9%	0.0%	3.6	-53.1	1.0	-3.8	-3.9	-4.0	0.7	0.5	-50.0	2.5	NR
Oc Oerlikon Corp	201%	5.4	64%	-60%	0.8	2%	-36.9%	0.0%	7.3	-31.8	2.0	-15.4	NM	NM	-4.5	0.0	-71.4	3.0	NR
Skanska Ab	-26%	10.4	109%	11%	1.6	8%	10.6%	7.1%	-0.2	-22.5	3.0	-1.7	-4.3	-0.7	-0.2	0.0	6.7	3.0	NR
Vossloh Ag	14%	12.2	143%	74%	2.4	99%	6.9%	3.5%	3.5	-24.8	1.0	3.2	1.2	6.3	-2.5	1.5	-8.3	3.5	NR
Spirax-Sarco Eng	8%	11.9	140%	39%	2.9	49%	8.6%	3.6%	7.3	-41.3	1.0	1.0	0.3	1.0	1.3	2.0	-45.5	4.0	NR
Alstom	9%	10.2	95%	27%	5.8	226%	7.7%	2.6%	15.1	-35.9	2.0	10.8	0.2	-1.2	-0.5	1.0	-36.4	4.0	Neutral
Kone Corporation	23%	8.8	104%	12%	4.9	342%	10.7%	6.1%	4.6	-20.2	2.0	3.6	-0.1	-0.4	0.6	1.0	-11.1	4.0	Outperform
Zardoya-Otis	0%	22.5	264%	70%	20.3	103%	3.9%	4.4%	-7.0	-60.4	2.0	-17.7	0.7	0.1	0.6	1.5	-69.2	4.5	NR

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Our European analysts' least favoured stocks are ABB, Legrand and Atlas Copco.

We also screen for the US capital goods stocks that are expensive on HOLT and P/B relatives are below average.

Figure 65: US capital goods that are expensive on HOLT

Name	Net Debt as a % of Mcap	P/E (12m fwd) Abs	P/E rel to Industry	P/E rel to mkt % above/below average	P/B Abs	P/B rel to mkt % above/below average	Yield (08e) FCY	Yield (08e) DY	HOLT Implied CFROI less 5-year average	HOLT Price, % change to best	Valuation score	Momentum CFROI	Momentum 1m EPS	Momentum 3m EPS	Momentum 3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Fastenal Co	11%	19.3	464%	7%	4.7	21%	4.8%	1.8%	4.9	-46.4	0.0	1.3	-1.1	-0.9	-1.5	0.5	-60.0	1.5	NR
Granite Construction Inc	0%	18.1	191%	95%	2.3	66%	4.0%	1.2%	4.0	-39.2	0.0	2.0	8.7	19.8	1.7	2.0	-75.0	3.0	NR
Grainger (W W) Inc	13%	12.6	303%	24%	2.5	41%	6.9%	2.3%	3.1	-16.0	1.0	1.6	-1.2	2.2	-0.7	1.0	-33.3	3.0	NR
Paccar Inc	-13%	13.5	159%	70%	2.1	11%	-1.2%	4.5%	-4.5	-22.0	2.0	-5.2	-6.3	-12.4	-6.4	0.0	-27.3	3.0	Neutral
Cooper Industries Ltd	49%	9.4	88%	5%	1.7	25%	12.0%	3.5%	-0.7	-16.1	4.0	-1.4	-3.6	-4.4	-2.1	0.0	-46.7	5.0	Neutral
Caterpillar Inc	43%	8.6	100%	-7%	2.7	22%	11.9%	3.8%	-4.8	22.6	4.0	-0.6	0.0	-1.8	0.9	0.5	-50.0	5.5	Neutral
Rockwell Automation	39%	9.2	85%	10%	2.3	28%	14.1%	3.7%	-0.1	-12.9	4.0	-0.2	0.0	-1.5	0.1	0.5	-60.0	5.5	Neutral
L-3 Communications Hldgs	75%	9.2	110%	-16%	1.4	13%	12.3%	1.7%	-8.7	64.1	4.0	-0.6	0.1	1.8	-0.7	1.0	-20.0	6.0	Neutral
Parker-Hannifin Corp	57%	7.4	86%	-13%	1.3	1%	16.2%	n/a	-2.1	23.3	6.0	1.1	0.0	0.0	0.0	0.5	-60.0	7.5	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT®, Credit Suisse research

Our US analysts' least favoured stock is Rockwell.

The two areas of capital spending that we would consider are: first, areas related to the US housing cycle, which we suspect turns at the end of the first quarter of 2009; and second, infrastructure-related areas. The following names have some exposure to US housing (albeit below 10% of total sales) and look relatively cheap on P/E relatives and HOLT. We discuss the infrastructure related plays on page 51 but find few companies that generate more than half of their revenue from infrastructure.

Figure 66: Capital goods stocks with exposure to US housing

Name	Sales exposure to US housing	P/E (12m fwd) Abs	P/E rel to Industry	P/E rel to mkt % above/below average	P/B Abs	P/B rel to mkt % above/below average	Yield (08e) FCY	Yield (08e) DY	HOLT Implied CFROI less 5-year average	HOLT Price, % change to best	Valuation score	Momentum CFROI	Momentum 1m EPS	Momentum 3m EPS	Momentum 3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Tomkins	10%	8.6	89%	15%	0.8	-65%	14.6%	11.0%	-1.0	1.1	6.0	-1.0	1.2	5.4	16.7	1.5	-83.3	8.5	NR
Deere & Co	8%	8.3	98%	-2%	2.1	38%	6.7%	2.9%	-1.9	20.9	5.0	2.7	0.0	-0.3	-0.2	0.5	-17.7	6.5	Outperform
Caterpillar Inc	8%	8.6	100%	-7%	2.7	22%	11.9%	3.8%	-4.8	22.6	4.0	-0.6	0.0	-1.8	0.9	0.5	-50.0	5.5	Neutral
Assa Abloy	6%	10.0	96%	-9%	2.2	-6%	9.7%	3.9%	-1.1	-17.0	5.0	-1.0	-0.6	1.7	1.3	1.0	-68.4	7.0	NR
Legrand Sa	6%	10.8	101%	n/a	1.8	n/a	13.0%	4.9%	1.2	-31.2	3.0	-0.7	-1.3	-5.4	-1.3	0.0	-87.5	4.0	Underperform
Schneider Electric	4%	8.3	78%	-18%	1.4	24%	14.4%	6.8%	-2.8	23.9	6.0	2.5	-0.4	-0.4	0.5	1.0	-4.8	8.0	Neutral
Terex Corp	3%	4.2	49%	-31%	0.7	-53%	32.9%	0.0%	-8.0	98.7	6.0	-1.2	-1.9	-13.3	-1.8	0.0	-6.7	7.0	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT®, Credit Suisse research

Finally and most importantly, there is still the prospect of further cuts in corporate discretionary spending. Below we rank sectors according to their exposure to corporate discretionary spend.

Figure 67: Sector exposure to corporate spending (latest estimates)

Sector	Sales to corporates, % total
IT services	95%
Software	79%
Capital goods	70%
Media	70%
Semi-conductors	68%
Hotels	60% - 70%
Airlines	50%
Telecom equipment	41%
Logistics	40%
Aerospace	39%
Building	33%

Source: Credit Suisse estimates

Valuations of corporate discretionary spend in aggregate

On aggregate, the sectors most exposed to corporate spending are expensive on P/B relatives and are still not cheap on forward P/E relative to the market.

Figure 68: Corporate discretionary spend: 12-month forward P/E relative to global market

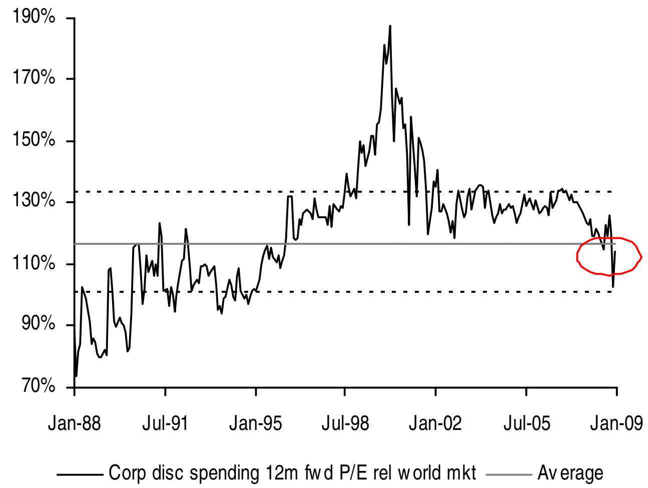


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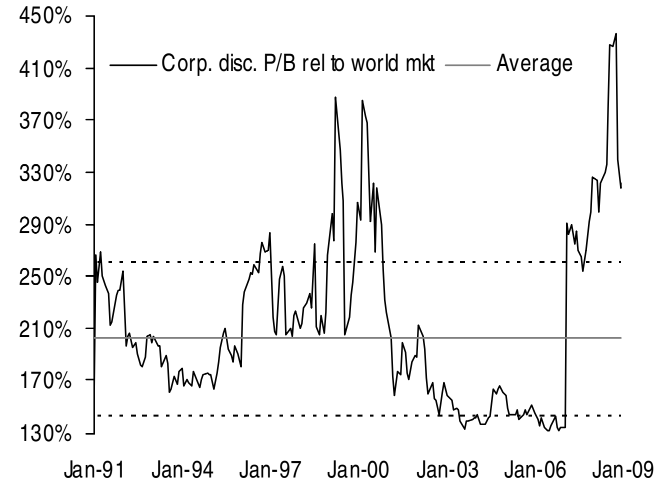
Figure 69: P/B relative of corporate spend-related sectors is not cheap



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Oddly enough in aggregate the corporate discretionary spend areas of the market have outperformed by 6% since the US officially entered recession in December 2007. We can see in Figure 70 that this group of stocks typically underperforms by 11% the year after a recession begins.

Figure 70: Relative performance of corporate discretionary spend basket in recessions

	---------------- Relative performance ----------------				
Date of recession start	1m	3m	6m	12m	18m
Jul-90	-2.7%	-10.5%	-14.5%	-16.3%	-11.7%
Mar-01	-5.0%	1.4%	-6.6%	-6.3%	-18.7%
Average	-3.9%	-4.5%	-10.5%	-11.3%	-15.2%
Dec-07	2.1%	-1.0%	0.1%	6.2%	-

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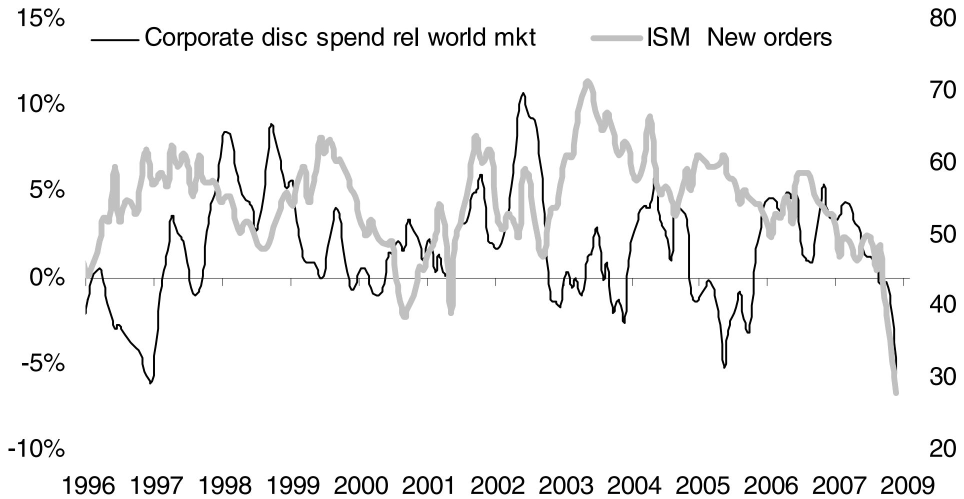
The relative earnings momentum of the corporate discretionary spend in aggregate looks terrible.

Figure 71: Relative earnings momentum of global corporate discretionary spend versus ISM new orders



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Below we show a scorecard of the individual sub-components of the corporate discretionary spend group. We rank sectors on the following criteria:

(i) P/B relative;

(ii) HOLT's value-to-cost;

(iii) FCF yield;

(iv) leverage (net debt as a percentage of market cap);

(v) earnings beta with capex; and

(vi) earnings momentum.

Figure 72: Corporate discretionary areas scorecard on P/B, value to cost (relative to average), earnings momentum, FCF yield, leverage

Sector	Price to book rel	Value to cost	FCF yield	Net debt / M cap	EPS beta with capex	Earnings momentum	Overall Rank
Media	82%	1.27	8.2%	27%	0.12	-18%	1
IT Services	177%	2.40	5.8%	2%	0.06	-18%	2
Software	260%	2.70	6.4%	-7%	0.54	-19%	3
Hotels	175%	1.24	3.4%	20%	0.40	-16%	4
Short cyc cap goods	94%	0.74	13.3%	28%	0.51	-21%	5
Airlines	51%	0.88	-3.0%	25%	0.42	-9%	6
Semis	112%	0.80	3.7%	-8%	0.58	-34%	7
Cap Goods	99%	1.19	5.1%	21%	0.22	-21%	8
Disc Spending inc S/W	**326%**	**1.40**	**5.9%**	**23%**	**0.36**	**-17%**	
Disc Spending ex S/W	**283%**	**1.36**	**4.7%**	**43%**	**0.33**	**-18%**	

Price to book and value to cost are ranked according to their deviation from their long-run average

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Media looks the cheapest of the corporate spend sectors—capital goods and airlines are two of the most expensive.

In Figure 73 we supply the list of companies in sectors most exposed to corporate spending that are 20% expensive on HOLT. We highlight Underperform-rated stocks JC Decaux and Legrand.

Figure 73: European stocks exposed to corporate discretionary spend with downside on HOLT-

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum --------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Air France-Klm	8.1	47%	15%	0.2	-52%	-9.9%	3.1%	2.4	-94.6	2.0	-3.2	-13.7	-20.6	-1.7	0.0	-30.0	3.0	NR
Itv	16.7	157%	41%	1.0	19%	6.4%	4.0%	4.1	-99.9	2.0	-1.5	-5.6	-15.7	-1.0	0.0	-71.4	3.0	Neutral
Jc Decaux Sa	12.9	121%	-16%	1.2	-24%	0.7%	3.8%	2.5	-27.6	3.0	-0.5	-1.6	-5.6	-0.7	0.0	-33.3	4.0	Underperform
Rezidor Hotel Grp	15.4	128%	n/a	1.5	n/a	5.5%	3.9%	3.6	-184.1	3.0	-0.3	0.0	-23.9	-4.5	0.0	-33.3	4.0	Neutral
Legrand Sa	10.8	101%	n/a	1.8	n/a	13.0%	4.9%	1.2	-31.2	3.0	-0.7	-1.3	-5.4	-1.3	0.0	-87.5	4.0	Underperform
British Airways	-38.6	-225%	-678%	0.6	-36%	3.2%	1.7%	0.6	-27.7	3.0	-4.9	NM	NM	0.3	1.0	-14.3	5.0	NR
Schibsted Asa	8.9	84%	0%	0.9	-57%	16.2%	8.0%	3.2	-42.4	4.0	-1.2	-15.6	-25.8	-1.8	0.0	-7.7	5.0	NR
Thomson-Reuters Pl	10.9	103%	n/a	1.0	n/a	10.3%	5.0%	0.3	-44.8	3.0	-4.9	2.7	2.6	3.3	1.5	-64.7	5.5	Neutral
Ericsson(Lm)Tel	13.7	116%	2%	1.6	-34%	9.0%	3.2%	1.4	-19.6	3.0	-2.3	2.1	4.4	2.5	1.5	-48.7	5.5	Underperform
Antena 3 Tv	14.4	136%	54%	3.2	-37%	10.5%	9.2%	-2.9	-38.0	4.0	-5.8	0.4	-18.5	-5.1	0.5	-100.0	5.5	Neutral
Havas	7.7	73%	-16%	0.7	-38%	14.0%	3.0%	2.6	-44.2	4.0	4.5	-1.4	-4.9	-0.2	0.5	-40.0	5.5	Underperform
Eads(Euro Aero Def	6.7	80%	-19%	0.7	3%	10.2%	2.6%	1.9	-17.4	3.0	1.5	10.7	8.9	0.7	2.0	-33.3	6.0	Underperform
Prosiebensat1 Medi	2.0	19%	-82%	0.4	-81%	87.0%	53.1%	1.0	-210.2	5.0	-2.9	-0.1	-21.0	-3.1	0.0	-73.9	6.0	Neutral
Aegis Group	7.9	75%	-8%	2.1	-57%	15.3%	3.7%	-1.7	-30.5	6.0	-0.3	-0.1	-0.2	2.5	0.5	10.0	6.5	Neutral

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

In Figure 74 we show the same for the US sectors:

Figure 74: US stocks exposed to corporate discretionary spend with downside on HOLT

		-----P/E (12m fwd) ------			------ P/B ------		Yield (08e)		HOLT			----------- Momentum ------------							
Name	Net Debt as a % of Mcap	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Marriott Intl Inc	105%	12.5	104%	9%	4.2	101%	1.0%	2.0%	3.9	-46.1	0.0	-0.7	-1.8	-9.4	-1.8	0.0	0.0	0.0	NR
Directv Group Inc	20%	13.0	122%	n/a	4.2	n/a	1.0%	0.0%	7.1	-23.5	0.0	2.8	-2.9	-4.6	-0.1	0.5	42.9	0.5	Neutral
Salesforce.Com Inc	-9%	66.8	605%	n/a	7.1	n/a	0.0%	0.0%	5.6	-61.6	0.0	0.9	3.5	1.1	-0.5	1.5	0.0	1.5	Neutral
Red Hat Inc	-20%	21.0	190%	n/a	2.2	n/a	5.0%	0.0%	4.3	-47.1	0.0	3.8	0.1	-0.3	-1.8	1.0	-45.5	2.0	NR
Applied Materials Inc	-12%	28.5	159%	133%	1.8	-25%	7.6%	2.2%	0.4	-41.4	2.0	-5.6	-0.2	-0.9	-0.2	0.0	7.7	2.0	Neutral
Washington Post -Cl B	31%	15.4	145%	21%	1.1	-41%	5.3%	n/a	1.2	-33.5	2.0	-1.1	NM	NM	NM	0.0	n/a	2.0	NR
Foundry Networks Inc	-39%	21.7	183%	18%	2.1	24%	4.4%	n/a	4.2	-44.1	0.0	-0.1	0.9	1.9	0.1	1.5	-20.0	2.5	NR
Saic Inc	20%	15.2	124%	n/a	1.9	n/a	5.3%	0.0%	9.2	-41.0	1.0	2.4	0.0	0.2	0.1	1.5	6.7	2.5	NR
Automatic Data Processing	1%	15.6	127%	n/a	4.1	n/a	6.5%	n/a	10.8	-35.0	2.0	3.8	0.0	0.0	0.0	0.5	11.1	2.5	Neutral
Liberty Global Inc	476%	110.9	1044%	34%	0.8	-13%	11.8%	0.0%	5.7	-124.4	2.0	3.8	-83.5	-69.3	-2.4	0.5	77.8	2.5	NR
Vmware Inc -Cl A	-16%	20.6	187%	n/a	4.8	n/a	-3.0%	0.0%	-47.2	-58.6	1.0	-26.7	0.1	4.1	-0.8	1.0	-69.7	3.0	Underperform
Amr Corp/De	800%	4.7	27%	-35%	2.9	265%	-29.3%	0.0%	4.3	-164.1	2.0	-4.9	NM	NM	0.1	1.0	14.3	3.0	Neutral
Wynn Resorts Ltd	74%	20.8	174%	-49%	2.7	-2%	-13.7%	0.0%	10.6	-85.2	2.0	2.7	-0.5	-12.1	-2.4	0.5	-26.3	3.5	Neutral
Analog Devices	-20%	16.0	90%	28%	2.2	4%	10.8%	4.2%	0.9	-25.5	3.0	1.7	-0.8	-1.3	-0.7	0.5	18.2	3.5	Neutral
Cablevision Sys Corp -Cl A	283%	13.1	123%	-86%	-0.8	n/a	12.8%	1.1%	6.7	-86.4	2.0	1.9	3.5	5.1	0.7	2.0	12.5	4.0	NR
Starwood Hotels&Resorts	188%	12.0	100%	-21%	1.6	37%	9.4%	5.6%	2.8	-75.9	3.0	-1.6	-0.2	-5.9	-3.1	0.0	-26.3	4.0	NR
Microchip Technology Inc	5%	14.2	79%	-5%	3.6	47%	8.7%	7.0%	3.3	-41.6	4.0	-1.2	-1.2	-11.4	-8.8	0.0	7.7	4.0	Restricted
Paychex Inc	-3%	15.7	128%	-20%	7.7	16%	5.9%	4.7%	0.4	-21.4	3.0	4.5	-0.2	-1.7	-1.7	0.5	-41.2	4.5	Neutral
Cisco Systems Inc	-16%	11.9	101%	-23%	2.9	-42%	8.4%	n/a	0.0	-17.3	4.0	0.4	0.0	0.0	0.0	0.5	15.2	4.5	Neutral
Xilinx Inc	-5%	12.1	68%	-21%	2.9	14%	9.4%	3.4%	3.4	-19.5	4.0	1.8	-2.6	-6.7	-3.2	0.5	0.0	4.5	Neutral
Altera Corp	-14%	13.6	76%	-9%	5.1	59%	8.6%	n/a	3.0	-21.5	4.0	3.3	-1.1	0.7	-1.1	1.0	0.0	5.0	Neutral
Kla-Tencor Corp	-17%	25.4	142%	95%	1.2	-42%	15.6%	n/a	-0.9	-22.3	4.0	-0.1	0.0	0.0	0.0	0.0	-27.3	5.0	Underperform

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

(3) 'Masters of their own destiny'

We believe that companies that are likely to be the long-term winners are those companies that can shape their own destiny.

What does this mean? We screen for European companies with the following characteristics:

(a) Superior CFROI® both relative to the market and relative to their sector. We screen for stocks with CFROI® greater than their sector in eight out of the past ten years;

(b) low volatility of CFROI®;

(c) high FCF yield; and

(d) large cap (in excess of US$5bn).

This is an environment where the large companies should be able to consolidate on terms that are likely to be advantageous. Only the large companies will likely have access to capital markets. In addition, liquidity carries much more of a premium in a bear market and thus investors will, we suspect, want to buy large only companies.

We show a list of the best companies on these measures in Europe in Appendix 1.

We add two more criteria:

(e) All of the above plus leverage below peer group average. This means they should be able to out-live their competitors. (See Appendix 1).

(f) Bargaining power. We believe that low working capital is a proxy on *bargaining power.* If working capital is low or negative and improving (ie, falling), then corporates should be able to get advantageous terms from their suppliers.

Our SUPER SCREEN of European stocks (superior CFROI® both relative to market and relative to peers, low volatility of CFROI®, high FCF yield, large cap, leverage below peer group and best working capital positions) ends up highlighting: BAT, Nestle, Shire, TNT and Vodafone (all of which also saw their working capital improving over the past year), as well as Imperial Tobacco and Reckitt Benckiser.

Figure 75: **European SUPER SCREEN: Superior CFROI® relative to the market and the sector, low volatility of CFROI®, high FCF yield (>5%), large cap (>$5bn), low leverage relative to peers and low working capital**

Name	S&P Credit Rating	Net Debt as a % of Mcap	Sector leverage	CFROI co-eff of variation	2007 Sales/Net working capital	-----P/E (12m fwd) ------ Abs	rel to Industry	rel to mkt % above/below average	------ P/B ------- Abs	rel to mkt % above/below average	Yield (08e) FCY	DY	HOLT Implied CFROI less 5-year average	Price, % change to best	Valuation score	---------- Momentum ------------- CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
BAT	BBB+	24%	37%	23%	6.11	12.3	107%	80%	5.7	154%	7.0%	4.7%	11.6	-39.2	1.0	1.6	0.5	1.5	1.2	2.0	80.0	3.0	Outperform
Imperial Tobacco	BBB	28%	37%	11%	5.23	10.5	92%	49%	2.2	-95%	6.6%	4.1%	-25.4	-34.2	4.0	4.4	-0.1	-0.2	-0.2	0.5	57.9	4.5	Outperform
Kuehne&Nagel	n/a	49%	158%	12%	29.05	13.4	253%	52%	3.6	-7%	7.8%	5.2%	-1.3	-11.9	4.0	0.7	-1.0	-4.5	0.8	1.0	-5.3	6.0	Neutral
Nestle Sa	AA	21%	37%	13%	6.46	13.0	101%	38%	3.5	73%	5.8%	3.1%	5.3	-20.6	1.0	1.8	0.9	0.1	-0.1	1.5	16.7	2.5	Outperform
Reckitt Benck	A+	5%	14%	24%	-10.64	15.4	111%	59%	7.4	127%	5.6%	2.7%	5.5	-40.7	2.0	9.6	0.1	2.6	1.8	2.0	25.0	4.0	Outperform
Reed Elsevier	A-	28%	68%	23%	-8.31	10.8	101%	9%	13.6	377%	9.0%	4.1%	11.6	-44.0	2.0	7.9	0.6	1.2	5.3	2.0	-6.7	5.0	Outperform
Shire	n/a	13%	15%	26%	5.27	14.5	141%	n/a	7.0	n/a	8.2%	0.7%	-7.4	67.9	4.0	6.0	-2.3	5.2	2.2	1.5	44.4	5.5	NR
Thomson-Reuters	n/a	54%	68%	13%	-110.55	10.9	103%	n/a	1.0	n/a	10.3%	5.0%	0.3	-44.8	3.0	-4.9	2.7	2.6	3.3	1.5	-64.7	5.5	Neutral
Tnt Nv	BBB+	80%	158%	20%	83.50	7.6	58%	-2%	3.0	26%	15.2%	5.9%	-0.7	0.9	6.0	0.0	-2.5	-8.9	-0.8	0.5	9.1	6.5	Outperform
Vodafone Group	A-	50%	89%	22%	-4.12	9.4	79%	-15%	0.9	-75%	12.9%	5.9%	-4.6	10.2	7.0	-1.1	-0.1	0.2	0.2	1.0	9.1	8.0	Neutral

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

We repeat this exercise for the US stocks.

Figure 76 shows a **SUPER SCREEN of the US stocks.** This highlights: Coca Cola, Hershey, Sherwin-Williams, P&G (all of which also saw their working capital improve over the past year), as well as Sysco, Pepsico, Staples, Public Services Ent, Colgate-Palmolive, Reynolds American and United Technologies. (See Appendix 1 for more details).

Figure 76: US SUPER SCREEN: Superior CFROI® relative to the market and the sector, low volatility of CFROI®, high FCF yield (>5%), large cap (>US$5bn), low leverage relative to peers and low working capital

						-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	S&P Credit Rating	Net Debt as a % of Mcap	Sector leverage	CFROI co-eff of variation	2007 Sales/Adjusted NWC	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Emerson Electric Co	A	23%	34%	17%	7.72	11.1	104%	7%	2.6	13%	9.2%	3.7%	3.0	-17.6	2.0	2.0	0.0	-0.1	0.1	1.0	0.0	3.0	Outperform
Coca-Cola Co	A+	4%	34%	10%	5.95	13.6	107%	-8%	4.4	-42%	6.1%	3.4%	6.4	-30.5	3.0	-0.2	0.1	1.1	-2.9	1.0	50.0	4.0	Neutral
Hershey Co	A	30%	34%	13%	6.07	18.4	142%	60%	12.9	202%	5.2%	3.4%	9.1	-64.0	2.0	-2.1	0.0	0.4	0.2	1.0	-100.0	4.0	Neutral
Air Products & Chem	A	55%	69%	14%	7.70	10.3	117%	5%	2.0	21%	7.4%	3.0%	2.4	-12.7	1.0	1.3	0.0	-3.0	-0.8	0.5	33.3	1.5	Outperform
Sysco Corp	AA-	19%	43%	11%	27.08	10.9	85%	-12%	3.8	3%	7.2%	n/a	-0.1	-16.9	5.0	-0.2	0.0	0.0	0.0	0.0	-50.0	6.0	NR
Jacobs Engin	n/a	8%	34%	12%	8.45	13.4	141%	22%	2.8	16%	6.7%	0.0%	0.6	-4.8	1.0	2.7	0.0	0.5	0.0	1.0	33.3	2.0	Outperform
Pepsico Inc	A+	16%	34%	8%	12.99	13.3	105%	12%	5.0	26%	5.5%	3.1%	2.7	-21.8	1.0	0.7	0.0	-1.7	0.1	1.0	46.7	2.0	Outperform
Sherwin-Williams Co	A-	45%	65%	8%	9.31	12.9	97%	49%	4.3	116%	7.3%	2.5%	1.5	-17.2	2.0	-0.3	0.0	4.9	0.9	1.0	-33.3	4.0	NR
Fluor Corp	A-	-1%	34%	20%	11.05	12.3	129%	0%	3.2	43%	5.4%	1.2%	3.6	-33.1	2.0	3.2	0.9	2.0	-1.6	1.5	41.2	3.5	Outperform
Procter & Gamble Co	AA-	26%	30%	14%	14.15	14.1	101%	21%	2.8	-28%	6.3%	2.4%	10.1	-46.6	2.0	0.8	0.0	0.0	0.0	0.5	0.0	2.5	NR
Johnson Controls Inc	A-	67%	406%	18%	15.88	10.0	107%	30%	1.2	-9%	11.2%	2.3%	-1.1	-6.0	3.0	-0.2	0.0	0.0	-0.4	0.0	-57.1	4.0	Outperform
Staples Inc	BBB	59%	65%	12%	9.84	12.0	91%	-18%	2.0	-13%	7.3%	1.9%	1.2	-19.0	4.0	1.3	-1.0	-5.3	-1.2	0.5	41.2	4.5	Outperform
Public Service Entrp Grp	BBB	74%	118%	14%	10.78	9.1	91%	27%	1.9	75%	6.2%	4.7%	-1.2	3.0	4.0	0.6	0.0	-1.5	-1.0	0.5	0.0	4.5	Outperform
Colgate-Palmolive Co	AA-	18%	30%	6%	16.42	14.1	101%	22%	13.2	49%	5.5%	2.6%	4.4	-26.8	1.0	2.0	0.1	-0.9	-2.0	1.0	29.4	2.0	NR
Reynolds American Inc	BBB-	29%	34%	25%	7.36	8.7	76%	24%	1.6	129%	11.1%	8.1%	-2.5	-2.1	4.0	-0.5	0.1	2.0	0.4	1.5	-33.3	6.5	Neutral
Dell Inc	A-	-6%	-1%	21%	38.72	9.1	82%	-22%	8.2	-13%	10.6%	0.0%	-6.5	-0.6	5.0	0.0	0.3	-5.5	-6.6	0.5	-17.2	6.5	Outperform
Precision Castparts Corp	BBB+	7%	34%	22%	5.42	6.5	77%	n/a	1.7	n/a	12.5%	0.2%	-13.2	130.3	6.0	1.4	-0.5	-6.5	-4.2	0.5	75.0	6.5	Outperform
United Technologies Corp	A	32%	34%	24%	9.01	9.5	113%	11%	2.2	21%	10.0%	2.7%	-2.2	20.5	3.0	1.9	-0.2	-0.3	-1.6	0.5	44.4	3.5	Outperform
General Dynamics Corp	A	14%	34%	16%	6.20	8.0	95%	-2%	1.7	14%	10.5%	2.4%	-4.8	36.6	5.0	1.9	0.0	0.9	-1.3	1.0	20.0	6.0	Neutral

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Companies with superior structural sales growth in their sector- the analysts' view

We surveyed our analysts in Europe, the US and Asia to find out which stocks in their sector they consider to have superior structural sales growth. We show the best-positioned companies in Appendix 2, as well as screens of these stocks that also look cheap on HOLT and are trading on a P/B relative below norm.

(4) Non-Japan Asia will drive global growth

We believe strongly that the main driver of global growth will be Non-Japan Asia and China in particular. In our view, Non-Japan Asia has three particular advantages:

(1) NJA has considerable macro-economic flexibility
It has huge foreign exchange reserves and a very large current account surplus, as shown below.

Figure 77: **NJA has abnormally high FX reserves as a proportion of GDP**

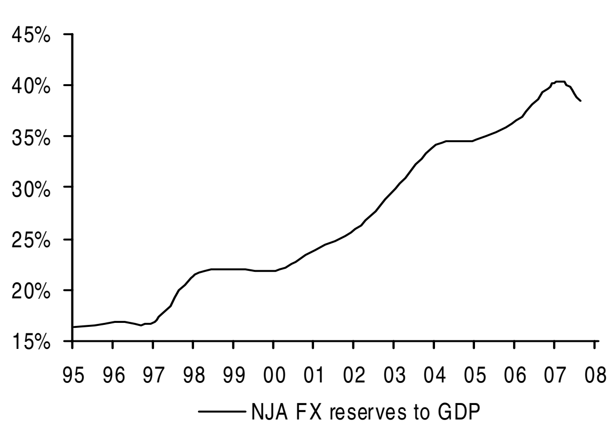

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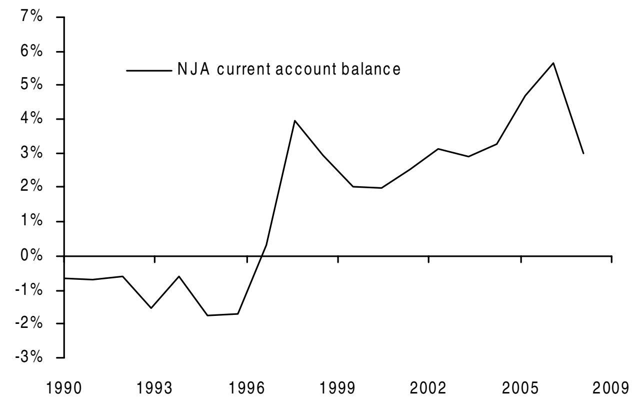
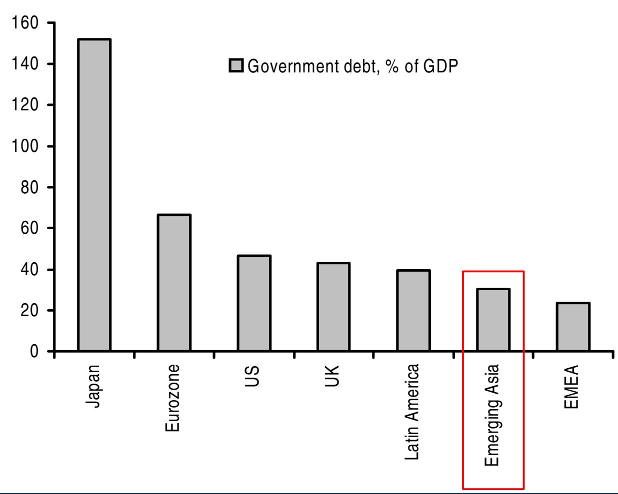
Figure 78: **NJA current account surplus**



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

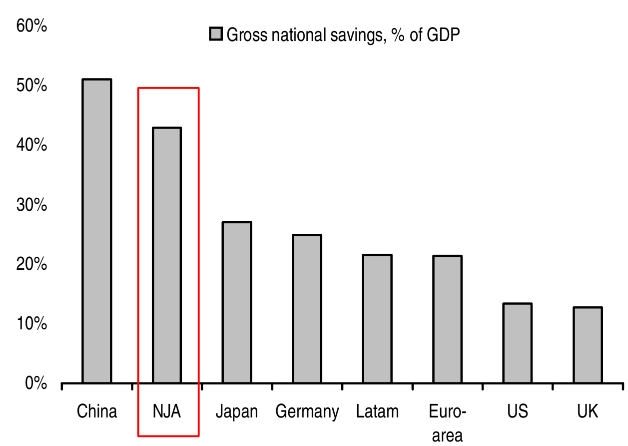
Government debt-to-GDP tends to be low in NJA in comparison with developed economies and the gross savings ratio is higher in NJA than anywhere else.

Figure 79: **Government debt to GDP (%) (last reported)**



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

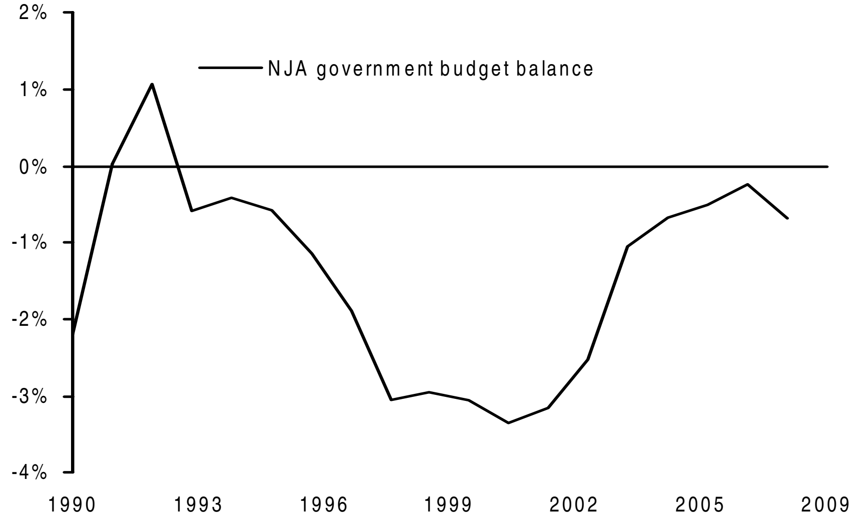
Figure 80: **Gross savings ratio (last reported)**



Source: IMF, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

The same is true for government deficits (indeed China has a record budget surplus).

Figure 81: NJA fiscal balance . . . still OK



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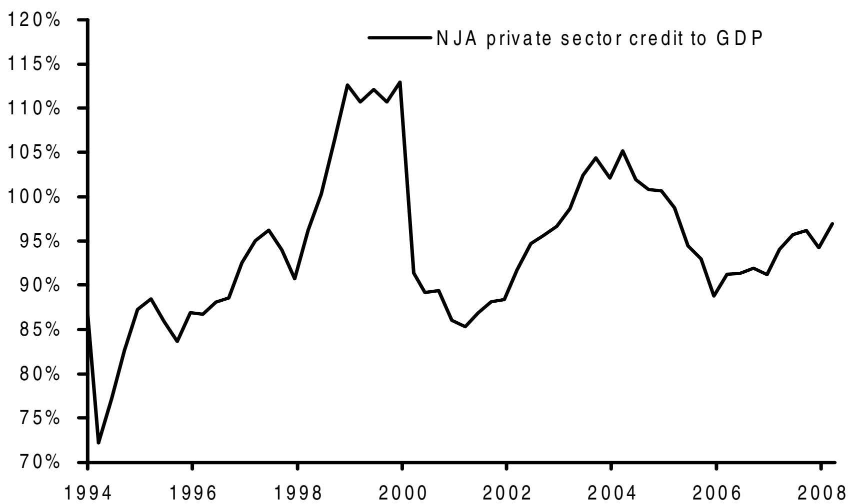
(2) Domestic balance sheets are lowly leveraged in NJA

We continue to believe that NJA has the best-positioned balance sheets to weather the downturn, with credit-to-GDP below previous peaks.

Figure 82: Non-Japan Asian private sector credit-to-GDP . . . below levels of a decade ago



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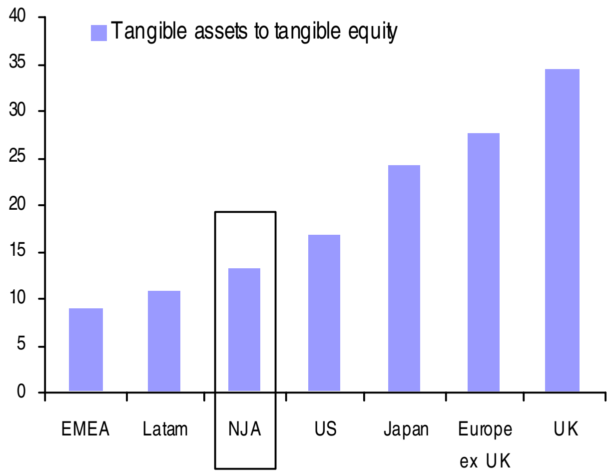
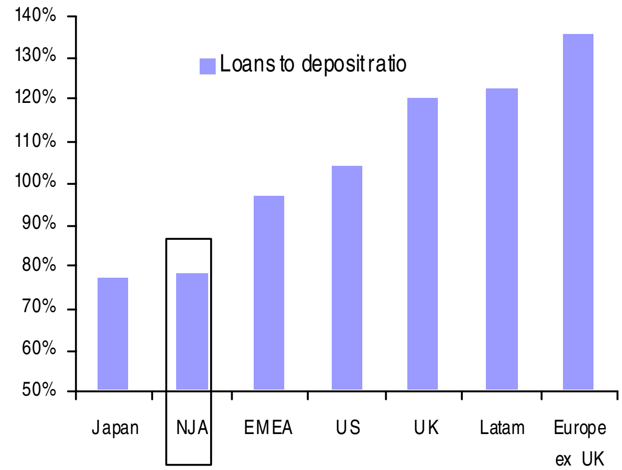
In addition, both bank leverage and loan/deposit ratios are lower than elsewhere.

Figure 83: **Global banks: Tangible assets to tangible equity (2008E)**



Source: Company data, Credit Suisse HOLT, Credit Suisse research

Figure 84: **Global banks: Loan-to-deposit ratio—NJA banks are underleveraged (2008E)**



Source: Company data, Credit Suisse HOLT, Credit Suisse research

(3) Non-Japan Asia benefits considerably from the huge fall in commodity prices

Not only are net oil imports nearly double the global norm but also food is a high proportion of the CPI (on average a third).

Figure 85: **Food weight in CPI is high in emerging economies (current)**

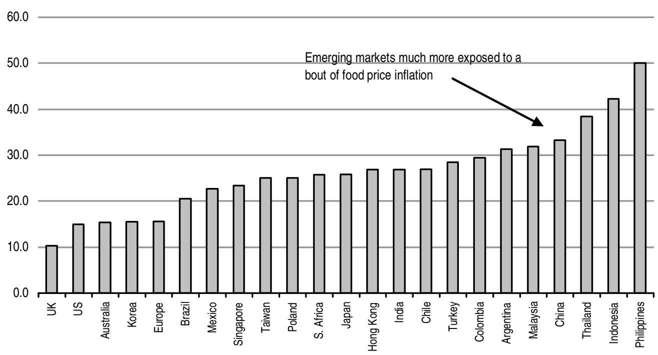


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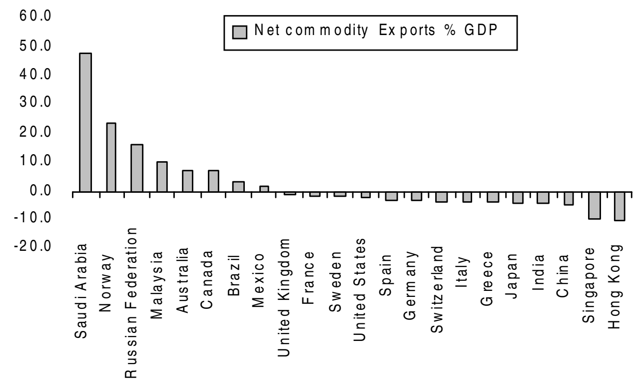
Figure 86: **Net commodity exports, as % of GDP (last reported)**



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

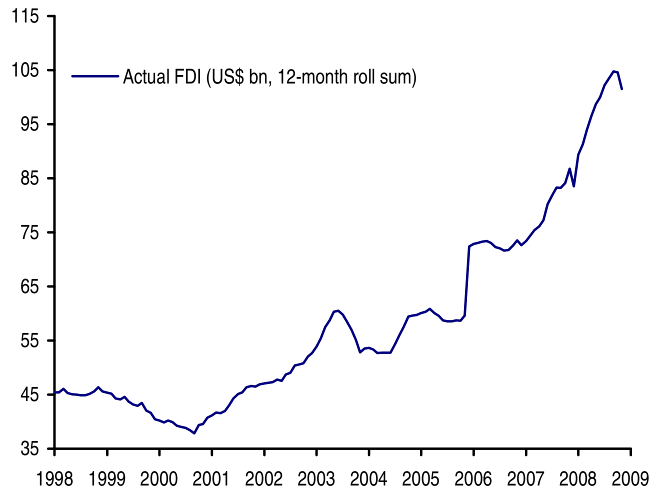
NJA has three other advantages:

(a) it is still a low-cost production centre and thus a recipient of FDI, especially China;

(b) it has relatively flexible labour forces and this is particularly important in a cost-cutting environment (we proxy by looking at the economic freedom index); and

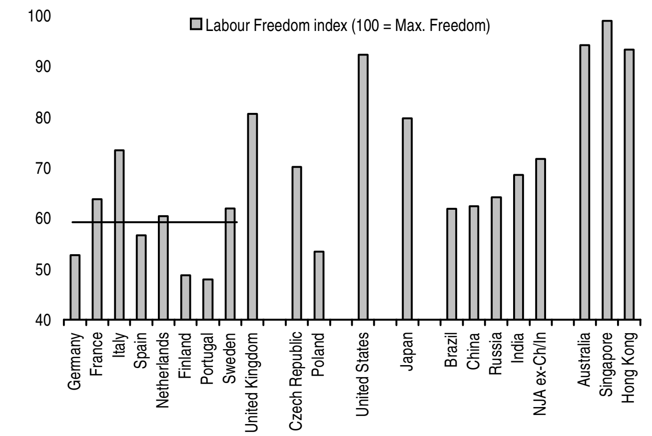
(c) due to its dollar peg it benefits from a zero Fed fund rate.

Figure 87: China FDI



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

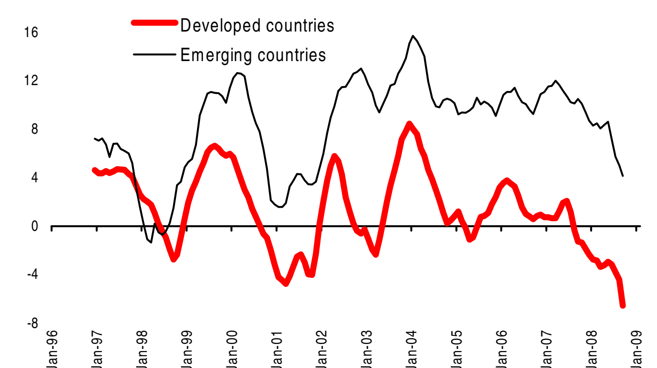
Figure 88: Labour Freedom index



Source: Heritage Foundation, Credit Suisse research

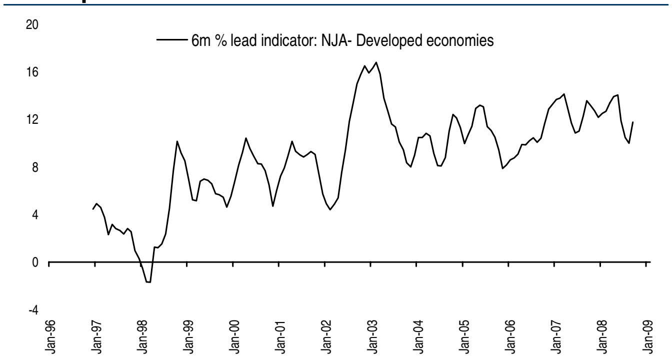
We can see some evidence of the relative resilience of NJA, with the positive gap between lead indicators in NJA and developed markets remaining constant, although clearly both have declined.

Figure 89: OECD leading indicators (6m ann. %)



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 90: OECD lead indicator—NJA relative to developed markets



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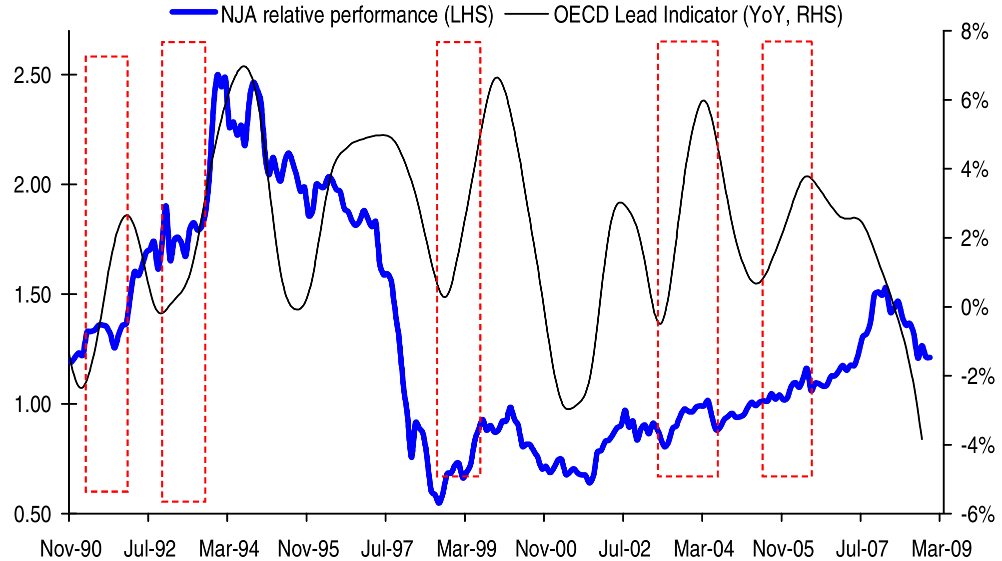
We also note that NJA outperformed nearly 90% of the time when lead indicators turn up (typically with a lead time of two months), as we show in Figure 91. We think that lead indicators turn in March/April next year.

Figure 91: NJA relative price performance versus OECD leading indicator



Source: OECD, MSCI, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 92: NJA relative price performance during times of rising OECD lead indicators

Trough in OECD lead indicators	Peak in OECD lead indicators	Number of months	NJA rel performance	----NJA performance from trough in OECD lead indicators--- 1 mth	3 mth	6 mth	12 mth
Jan-91	Jan-92	12	13.7	0.5	8.1	10.9	13.7
Sep-92	Jul-94	22	36.7	6.7	0.8	2.6	14.0
May-95	Dec-96	21	-12.7	2.6	-3.6	-12.4	-4.2
Oct-98	Oct-99	12	34.8	4.6	7.6	14.6	34.8
Apr-01	Apr-02	12	28.0	-0.7	-0.9	-5.7	28.0
Apr-03	Mar-04	11	20.2	-3.6	8.8	16.4	21.9
Apr-05	Apr-06	12	13.7	1.5	2.6	2.6	13.7
Average			**19.2**	**1.7**	**3.4**	**4.2**	**17.4**

Source: OECD, MSCI, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

We believe strongly that growth in Asia and the BRIC countries has to be more consumer focused with the investment share of GDP at an all-time high. Thus long term we would look to focus on the consumer plays as opposed to the investment plays.

Figure 93: **BRIC investment and consumption share of GDP**

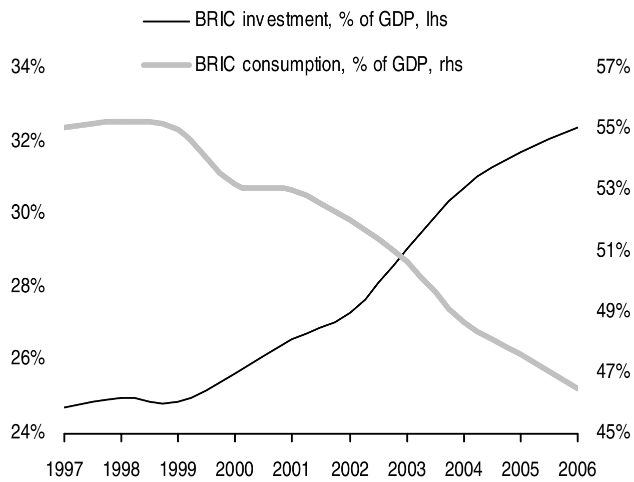


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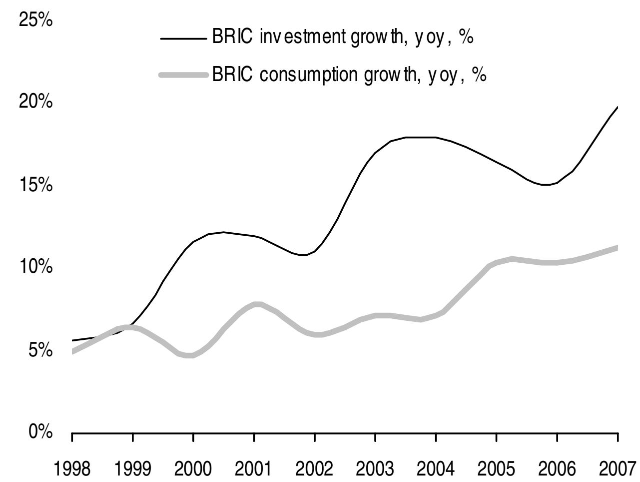
Figure 94: **BRIC investment and consumption growth**



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How to play it?

We believe we should be focusing on the ‘safe’ emerging markets (we include developed markets for comparison). We look at the following criteria:

(a) large current account surpluses (ie, they are the providers of global liquidity);

(b) low leverage (a low private sector to GDP ratio);

(c) low loan-to-deposit ratios;

(d) net foreign assets (for which we look at the net international investment position);

(e) low (or even positive) short-term net foreign debt as a proportion of GDP (for this, we look at net short-term foreign debt minus FX reserves; we want countries that have enough hard currency to cover all, or at least a large part, of their short-term debt); and

(f) net commodity importers (ie, the terms of trade benefit from falling commodity prices).

Figure 95: Country vulnerability scorecard—the least risky countries (i.e. the best)at the bottom

	Country	2009 Current account balance / GDP	Private sector credit / GDP	Banks loan / deposits	Net external assets / GDP	Net short term external debt / GDP	Commodity exports / GDP	*CDS spreads*	Score
	Weighting	*2*	*1*	*1*	*1*	*0.5*	*1*		
1	Iceland	-20%	435%	204%	-147%	248%	1%	*1,050*	34
2	Bulgaria	-22%	71%	130%	-71%	-3%	6%	*575*	30
3	Estonia	-6%	96%	190%	-67%	29%	-2%	*585*	29
4	Latvia	-11%	30%	254%	-66%	17%	-2%	*930*	27
5	Lithuania	-15%	62%	150%	-48%	6%	-4%	*600*	26
6	Spain	-9%	166%	116%	-75%	-6%	-4%	*98*	26
7	Greece	-9%	81%	122%	-89%	-5%	-3%	*na*	25
8	United Kingdom	-3%	198%	126%	-25%	na	-1%	*110*	25
9	Romania	-13%	35%	122%	-37%	-2%	-3%	*700*	24
10	Hungary	-6%	63%	119%	-91%	-4%	-4%	*475*	23
11	South Africa	-6%	93%	92%	-14%	-4%	3%	*430*	22
12	Poland	-5%	45%	115%	-45%	-1%	-2%	*280*	22
13	Ireland	-2%	183%	111%	-16%	na	-2%	*208*	21
14	United States	-2%	226%	100%	-17%	na	-2%	*60*	21
15	Chile	-2%	77%	127%	-2%	-3%	21%	*240*	21
16	Denmark	1%	185%	167%	-4%	na	2%	*130*	21
17	Italy	-3%	85%	128%	-5%	3%	-3%	*178*	20
18	Colombia	-4%	34%	93%	-22%	-7%	6%	*na*	20
19	Ukraine	-4%	63%	150%	-16%	-9%	-9%	*3,000*	19
20	Brazil	-2%	51%	102%	-37%	-11%	1%	*365*	19
21	Turkey	-5%	38%	85%	-43%	-3%	-4%	*437*	18
22	Korea	0%	107%	130%	-27%	-13%	-10%	*370*	18
23	Mexico	-1%	18%	99%	-38%	-8%	2%	*363*	17
24	Russia	4%	43%	149%	-8%	-28%	22%	*750*	17
25	France	-1%	89%	120%	13%	na	-3%	*57*	16
26	Indonesia	1%	25%	67%	-32%	-4%	4%	*690*	14
27	India	-4%	53%	79%	-4%	-24%	-4%	*na*	14
28	Malaysia	9%	108%	73%	-3%	-44%	6%	*280*	13
29	Egypt	0%	40%	55%	-5%	-18%	3%	*600*	13
30	Thailand	1%	89%	92%	-21%	-26%	-10%	*310*	12
31	Argentina	1%	13%	83%	12%	-1%	3%	*4,005*	12
32	Hong Kong	10%	145%	94%	240%	-58%	-1%	*90*	12
33	Germany	8%	95%	102%	26%	na	-3%	*47*	11
34	Japan	4%	137%	77%	43%	na	-4%	*48*	10
35	China	8%	123%	60%	20%	-34%	-6%	*220*	8
36	Philippines	1%	27%	61%	-17%	-16%	-5%	*425*	8
37	Singapore	15%	105%	83%	84%	-85%	-9%	*na*	7

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We prefer countries with a current account surplus, net foreign assets, benefiting from falling commodity prices with low loan deposit ratio AND relatively closed economies (ie, exports are a low proportion of GDP). China ranks very well on this basis. Thailand and Philippines also look good.

Figure 96: We look for countries with low macro-economic risk, a relatively closed economy, high domestic sales exposure and that are commodity importers

Country	Risk score	Exports, % of GDP	Domestic share of corp revenues	Current account balance	Net commodity exports, % of GDP	Overall rank
Philippines	8	41%	87%	1.2%	-5.2%	1
China	8	39%	82%	7.5%	-5.9%	2
Thailand	12	77%	80%	0.5%	-9.8%	3

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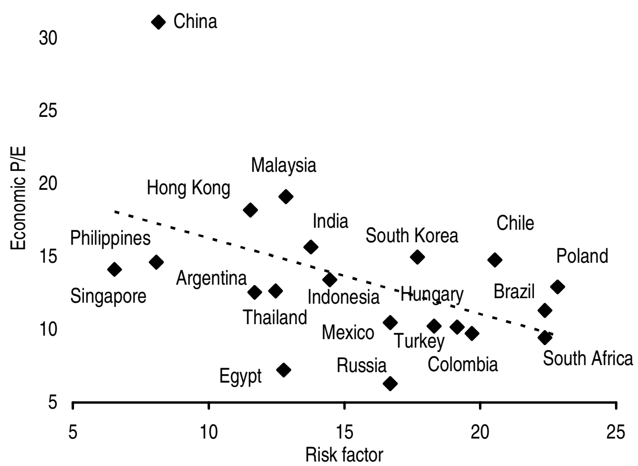
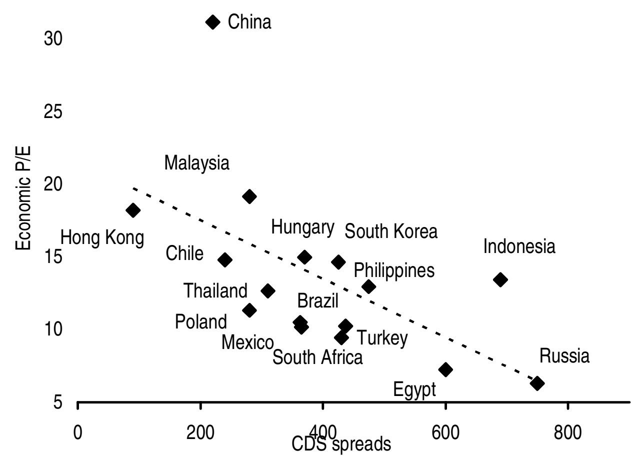
We would note that there appears to be a poor relationship between the economic P/E and the CDS spread—surely this is wrong.

Figure 97: Valuations do not seem to reflect risk differentials too well —no matter whether we look at our macro-economic risk score . . .



Source: Credit Suisse HOLT, Credit Suisse research

Figure 98: . . . or CDS spreads



Source: Credit Suisse HOLT, Credit Suisse research

Our Non-Japan Asia strategist Sakthi Siva would play her positive stance on the Asian market via *China and Banks*—both her biggest overweights. She also likes Korea and Hong Kong property.

We agree and would focus on the cheapest Outperform-rated banks, real estate, retailing, telecoms in the favoured regions (Hong Kong, China, Thailand, Korea, and Philippines).

Figure 99: Outperform-rated and attractively priced stocks in banks, real estate, utilities, retailing, telecoms in the favoured regions (Hong Kong, China, Thailand, Korea, Philippines)

		-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Sector	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Hutchison	Telecom	6.5	54%	-77%	0.2	-88%	33.9%	5.6%	-4.0	115.2	7.0	-1.9	13.5	14.8	0.6	1.5	-23.1	9.5	Outperform
Pusan Bank	Banks	3.6	46%	-24%	0.6	-30%	n/m	9.1%	-9.9	97.8	7.0	-0.4	-1.5	-2.9	7.0	0.5	-9.7	8.5	Outperform
Krung Thai Bnk Ltd	Banks	4.1	53%	-38%	0.4	-64%	n/m	10.9%	-6.0	96.9	7.0	1.5	-0.3	-10.4	0.3	1.0	20.0	8.0	Outperform
Dah Sing Financial	Banks	4.0	52%	-35%	0.4	-59%	n/m	9.4%	-4.2	36.8	7.0	-3.8	-1.2	-14.6	-9.5	0.0	-7.7	8.0	Outperform
Esprit Holdings	Retail	8.0	60%	-9%	3.5	-30%	10.7%	9.2%	-11.8	21.6	7.0	-2.1	0.0	0.0	0.0	0.0	-22.2	8.0	Outperform
Siam City Bank	Banks	4.1	53%	n/a	0.4	n/a	n/m	7.5%	-12.2	117.3	5.0	5.5	NM	NM	NM	2.0	-5.9	8.0	Outperform
Great Eagle Hldgs	Real Estate	4.4	43%	-42%	0.2	-50%	n/m	8.9%	-12.8	281.9	7.0	-0.1	4.4	-10.7	-2.1	0.5	38.5	7.5	Outperform
Energy Develop	Utilities	5.4	n/a	n/a	1.1	n/a	17.8%	8.8%	-2.9	35.7	7.0	-1.5	-1.1	0.3	-1.9	0.5	66.7	7.5	Outperform
Sk Telecom	Telecom	10.3	87%	68%	1.4	-13%	9.1%	4.3%	-5.8	16.6	6.0	-2.3	0.5	-0.3	-0.6	0.5	65.7	6.5	Outperform
Sun Hung Kai Prop	Real Estate	12.8	123%	61%	0.7	-21%	n/m	4.1%	-3.1	29.5	5.0	-0.7	0.0	2.0	-0.7	0.5	-15.8	6.5	Outperform
Robinsons Land Cp	Real Estate	5.2	50%	-13%	0.7	12%	n/m	9.3%	-5.4	56.7	6.0	-0.9	-0.4	-0.4	-1.6	0.0	71.4	6.0	Outperform
Globe Telecom Inc	Telecom	7.7	65%	-47%	1.9	39%	15.2%	13.8%	-0.2	6.9	6.0	-0.3	-2.5	-5.9	-2.4	0.0	63.6	6.0	Outperform
Cheung	Real Estate	9.9	95%	35%	0.7	-27%	n/m	3.2%	-23.4	40.9	5.0	0.0	-0.3	-1.8	1.7	1.0	25.0	6.0	Outperform
Lotte Shopping	Retail	7.6	64%	-19%	0.6	-38%	0.4%	0.8%	-3.6	35.8	5.0	-0.6	-0.1	-7.1	-1.2	0.0	-35.3	6.0	Outperform
Indus & Commer	Banks	6.8	88%	12%	0.6	-7%	n/m	7.5%	-2.8	12.1	5.0	-1.1	6.9	1.5	-3.4	1.0	33.3	6.0	Outperform
Greentown China	Real Estate	3.1	30%	n/a	0.5	n/a	n/m	7.6%	-2.1	-134.9	5.0	-3.0	-0.4	-5.2	-8.3	0.0	-16.7	6.0	Outperform
Daegu Bank	Banks	4.0	51%	2%	0.6	7%	n/m	8.7%	-12.0	84.7	5.0	-1.3	-2.8	-5.2	27.6	0.5	22.6	5.5	Outperform
Swire Pacific	Real Estate	10.7	103%	44%	0.6	-21%	n/m	5.2%	-5.4	54.4	5.0	-1.0	-2.5	-6.2	0.1	0.5	0.0	5.5	Outperform
Advanced Info Serv	Telecom	11.4	95%	7%	2.9	-1%	15.8%	8.8%	0.4	-33.4	4.0	1.7	0.5	1.4	-0.9	1.5	60.0	5.5	Outperform
Giordano Intl Ltd	Retail	8.3	63%	4%	1.3	-45%	13.5%	13.2%	1.9	-62.0	4.0	0.5	-0.3	-5.1	-4.6	0.5	-23.1	5.5	Outperform
Wharf(Hldgs)	Real Estate	10.8	104%	25%	0.5	-1%	n/m	4.2%	-5.2	63.8	5.0	-1.5	-0.7	-3.3	-2.0	0.0	50.0	5.0	Outperform
Metro Bank & Trust	Banks	6.7	87%	-26%	0.7	-45%	n/m	4.7%	1.4	10.0	5.0	-3.8	-10.7	-19.6	-0.9	0.0	55.6	5.0	Outperform
Dah Sing Banking	Banks	5.6	72%	n/a	0.5	n/a	n/m	5.3%	-0.5	8.3	5.0	-1.9	NM	NM	-7.9	0.0	27.3	5.0	Outperform
Sa Sa Intl Hldgs	Retail	8.1	61%	n/a	2.1	n/a	12.3%	11.7%	2.0	-44.1	4.0	-2.9	-0.6	-15.7	-5.3	0.0	-14.3	5.0	Outperform
Lifestyle Internat	Retail	9.8	83%	n/a	2.0	n/a	11.2%	3.7%	0.0	-59.2	4.0	-2.3	-3.2	-7.5	-1.4	0.0	-5.9	5.0	Outperform
China Mobile Ltd	Telecom	10.8	91%	12%	3.0	48%	5.7%	3.6%	-7.1	50.7	4.0	0.8	0.0	-1.2	-1.1	0.5	50.0	4.5	Outperform
Shinhan Fin Group	Banks	7.6	98%	54%	0.7	17%	n/m	2.2%	-4.7	14.9	4.0	-7.0	-5.3	-14.5	-66.1	0.0	48.4	4.0	Outperform
Manila Water Co	Utilities	8.4	62%	n/a	2.0	n/a	-7.7%	2.5%	-0.5	-44.2	3.0	-2.2	-1.3	-2.9	1.6	0.5	25.0	3.5	Outperform
Manila Electric Co	Utilities	10.9	92%	n/a	1.1	n/a	2.8%	2.3%	1.8	-7.3	1.0	0.4	1.3	-0.1	0.1	1.5	-14.3	3.5	Outperform
Philippine Lng Dis	Telecom	11.1	93%	62%	4.5	214%	9.4%	7.2%	5.8	-37.6	3.0	0.0	-0.1	-3.3	-1.8	0.0	38.5	3.0	Outperform
Belle Internationa	Retail	10.7	81%	n/a	2.2	n/a	4.5%	2.3%	-1.2	-48.0	3.0	-5.3	-1.8	-6.3	-5.7	0.0	25.0	3.0	Outperform
Cent Pattana Pub	Real Estate	16.2	155%	107%	2.1	-12%	n/m	2.9%	4.6	-58.8	1.0	1.1	3.6	3.8	1.3	2.0	100.0	3.0	Outperform
Lg Dacom	Telecom	8.4	82%	-53%	1.1	87%	4.6%	2.8%	2.6	-14.3	2.0	-0.3	-1.1	4.9	-0.7	0.5	57.1	2.5	Outperform
Hang Seng Bank	Banks	12.7	163%	43%	3.7	59%	n/m	5.8%	-0.9	-32.5	1.0	-0.7	-4.6	-9.3	-5.5	0.0	-5.3	2.0	Outperform
Hopewell Hldgs	Real Estate	14.7	141%	138%	0.9	46%	n/m	12.7%	5.5	-33.9	1.0	-2.7	0.0	0.0	NM	0.0	-33.3	2.0	Outperform
Sk Broadband Co	Telecom	178.5	1732%	n/a	0.8	n/a	10.4%	0.0%	8.1	-45.2	1.0	1.0	NM	NM	-2.8	1.0	0.0	2.0	Outperform
Ayala Land Inc	Real Estate	18.6	179%	6%	1.6	-45%	n/m	n/a	5.6	-34.6	1.0	1.4	-0.8	-1.4	-2.7	0.5	42.9	1.5	Outperform
China Res Pwr	Utilities	14.1	n/a	68%	2.2	45%	-8.4%	0.9%	-1.2	-21.5	1.0	-3.7	-32.9	-46.2	-3.7	0.0	21.7	1.0	Outperform
China Res Land	Real Estate	14.2	137%	57%	1.6	270%	n/m	1.1%	6.8	-72.1	0.0	0.2	0.5	-6.5	-6.0	1.0	52.9	1.0	Outperform
Hang Lung Group	Real Estate	14.1	136%	197%	0.8	51%	n/m	n/a	1.9	-25.9	0.0	2.5	0.0	0.0	NM	0.7	0.0	0.7	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

In the recent '*Asia Market strategy: 2009 Outlook*' (dated 4 December) our NJA *financials* analyst, Sanjay Jain's top picks are: ICBC, CCB, UOB. Our NJA *insurance* analyst, Chris Esson's top picks in the life insurance space are: China Life, Ping An, Cathay FHC, and in non-life: PICC, LIG Insurance, Hyundai Marine & Fire. Our NJA *telecoms* analyst, Colin McCallum would focus on: Idea, Bharti, CMHK, Excelcom, TMI, PLDT. Our favoured *property plays* are in Hong Kong: Swire, Wharf, Great Eagle and Sun Hung Kai Properties (Hong Kong benefits from its dollar peg as US rates fall to zero and its exposure to growth in China).

We also look at indirect plays. We highlight those European and US companies with sales exposure to Non-Japan Asia.

Figure 100: European and US stocks with more than 5% of sales from NJA and FCF yield above 5%

		-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum --------------							
Name	% Sales from NJA	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Intel Corp	49.8	16.0	89%	47%	2.0	-22%	7.4%	3.8%	0.6	-22.6	4.0	0.0	-10.3	-12.7	-5.0	0.5	26.8	4.5	Outperform
National	48.8	12.2	68%	11%	13.2	788%	9.3%	2.3%	1.3	-12.7	2.0	-1.7	-26.8	-35.2	-12.6	0.0	-18.2	3.0	Neutral
Texas Instruments	48.0	12.2	68%	1%	2.0	4%	13.4%	2.7%	-2.4	-1.3	3.0	-1.4	-0.8	-8.0	-3.8	0.0	-25.0	4.0	Neutral
Applied Materials Inc	46.4	28.5	159%	133%	1.8	-25%	7.6%	2.2%	0.4	-41.4	2.0	-5.6	-0.2	-0.9	-0.2	0.0	7.7	2.0	Neutral
Maxim Integrated	42.1	17.4	97%	18%	1.1	-66%	7.4%	6.4%	-7.1	18.0	6.0	-1.8	0.0	-0.5	0.0	0.0	-23.8	7.0	Neutral
Freeport-Mcmoran	36.8	17.3	326%	47%	0.5	-94%	24.1%	9.2%	-11.1	120.6	5.0	-1.1	-15.9	-47.4	-18.7	0.0	5.9	5.0	Outperform
Analog Devices	33.4	16.0	90%	28%	2.2	4%	10.8%	4.2%	0.9	-25.5	3.0	1.7	-0.8	-1.3	-0.7	0.5	18.2	3.5	Neutral
Yum Brands Inc	32.0	13.5	112%	41%	35.4	423%	5.0%	2.3%	4.6	-29.3	1.0	2.1	-0.1	-0.1	-0.4	0.5	-41.2	2.5	Outperform
Swatch Group	33.0	8.9	78%	4%	1.7	7%	9.5%	2.7%	-0.1	3.7	5.0	0.4	-3.6	-7.5	-1.6	0.5	9.1	5.5	Outperform
Altera Corp	25.5	13.6	76%	-9%	5.1	59%	8.6%	n/a	3.0	-21.5	4.0	3.3	-1.1	0.7	-1.1	1.0	0.0	5.0	Neutral
Richemont(Cie Fin)	25.0	9.0	79%	n/a	1.1	n/a	9.5%	4.6%	-0.1	-11.4	6.0	-0.4	-0.3	-38.5	0.2	0.5	20.0	6.5	Outperform
LVMH	17.3	10.7	94%	-3%	2.1	-1%	7.1%	3.5%	2.8	-40.3	5.0	0.0	-0.9	-2.0	-0.1	0.5	58.6	5.5	Outperform
Schneider Electric	16.0	8.3	78%	-18%	1.4	24%	14.4%	6.8%	-2.8	23.9	6.0	2.5	-0.4	-0.4	0.5	1.0	-4.8	8.0	Neutral
Alstom	15.0	10.2	95%	27%	5.8	226%	7.7%	2.6%	15.1	-35.9	2.0	10.8	0.2	-1.2	-0.5	1.0	-36.4	4.0	Neutral
Bulgari Spa	14.8	12.5	109%	-4%	1.9	-34%	5.6%	5.9%	0.4	-32.0	4.0	-1.0	-11.6	-14.7	-2.4	0.0	-80.0	5.0	Neutral
Autodesk Inc	12.5	11.1	101%	-8%	3.3	-17%	10.3%	0.0%	-9.1	3.4	5.0	-3.8	-8.5	-14.3	-6.3	0.0	-47.4	6.0	Neutral
Siemens Ag	12.0	8.7	90%	-8%	1.3	4%	7.7%	3.7%	3.4	-1.6	3.0	2.3	-0.5	-3.3	0.1	1.0	20.0	4.0	Outperform
Sandvik Ab	11.0	8.2	97%	2%	2.1	21%	9.9%	7.9%	-2.8	6.2	5.0	-1.6	-2.6	-6.0	-0.8	0.0	-40.7	6.0	Neutral
Cisco Systems Inc	10.0	11.9	101%	-23%	2.9	-42%	8.4%	n/a	0.0	-17.3	4.0	0.4	0.0	0.0	0.0	0.5	15.2	4.5	Neutral
Alcatel-Lucent	10.0	6.2	52%	-36%	0.4	-66%	34.9%	0.6%	-4.4	175.4	6.0	3.9	-6.6	-16.6	-1.2	0.5	-15.2	7.5	Outperform
Italcementi	9.6	9.7	100%	8%	0.7	-8%	5.8%	3.8%	-2.3	53.2	4.0	-1.8	-2.9	-12.9	1.4	0.5	-79.0	5.5	Neutral
Xilinx Inc	9.4	12.1	68%	-21%	2.9	14%	9.4%	3.4%	3.4	-19.5	4.0	1.8	-2.6	-6.7	-3.2	0.5	0.0	4.5	Neutral
Emerson Electric Co	9.0	11.1	104%	7%	2.6	13%	9.2%	3.7%	3.0	-17.6	2.0	2.0	0.0	-0.1	0.1	1.0	0.0	3.0	Outperform
Nestle Sa	8.0	13.0	101%	38%	3.5	73%	5.8%	3.1%	5.3	-20.6	1.0	1.8	0.9	0.1	-0.1	1.5	16.7	2.5	Outperform
Reckitt Benck Grp	8.0	15.4	111%	59%	7.4	127%	5.6%	2.7%	5.5	-40.7	2.0	9.6	0.1	2.6	1.8	2.0	25.0	4.0	Outperform
Henkel Ag&Co. Kgaa	7.0	10.3	74%	5%	1.8	8%	8.0%	2.4%	-1.2	3.5	4.0	-0.3	-1.0	-1.6	-0.1	0.0	-3.2	5.0	Neutral
Beiersdorf Ag	7.0	18.2	125%	28%	4.5	53%	5.3%	1.8%	8.1	-42.2	1.0	2.2	-0.6	-2.4	0.4	1.0	-3.2	3.0	Neutral
Sap Ag	6.7	14.1	128%	-20%	5.6	-17%	6.7%	1.8%	5.6	-26.6	4.0	6.4	-1.1	-5.2	-2.4	0.5	-4.8	5.5	Outperform
Philips Elec(Kon)	6.5	10.5	109%	22%	0.8	-10%	13.0%	4.5%	2.9	6.5	3.0	2.7	-7.4	-13.0	-3.6	0.5	-13.5	4.5	Outperform
Boeing Co	6.1	6.7	80%	-35%	3.4	74%	9.6%	3.9%	-4.7	55.4	6.0	-1.9	-1.0	-19.4	-8.9	0.0	13.0	6.0	Outperform
3M Co	6.0	10.9	113%	2%	3.2	3%	8.6%	3.8%	0.3	-10.1	1.0	-0.2	-1.1	-1.9	-1.9	0.0	12.5	1.0	Neutral
Upm-Kymmene Corp	5.2	12.8	89%	67%	0.8	21%	10.0%	7.1%	-0.5	25.3	5.0	0.3	2.1	0.1	-2.8	1.5	0.0	6.5	Neutral
Caterpillar Inc	5.0	8.6	100%	-7%	2.7	22%	11.9%	3.8%	-4.8	22.6	4.0	-0.6	0.0	-1.8	0.9	0.5	-50.0	5.5	Neutral
L'Oreal	5.0	16.2	111%	8%	3.5	17%	5.4%	2.4%	7.4	-37.2	1.0	-1.8	-0.3	-2.1	-0.3	0.0	-60.0	2.0	Neutral
Heinz (H J) Co	5.0	12.1	93%	23%	5.6	55%	7.6%	4.7%	8.1	-46.9	3.0	1.5	-0.3	-0.7	-4.2	0.5	16.7	3.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Our preferred consumer-related stocks are Yum Brands, Nestle, Swatch. The investment-related names are Alcatel, Alstom, and Siemens. Of these only Alcatel is clearly cheap on HOLT. It is interesting to note how cheap Standard Chartered has become relative to HSBC on price-to-book and price relative terms. Standard Chartered is trading on an 18% forward P/E discount to its regional peer group on consensus estimates.

Figure 101: Standard Chartered relative to HSBC: P/B close to bottom of its range

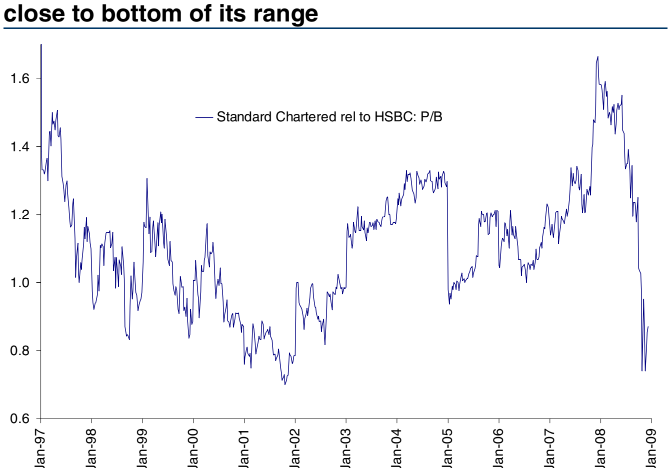


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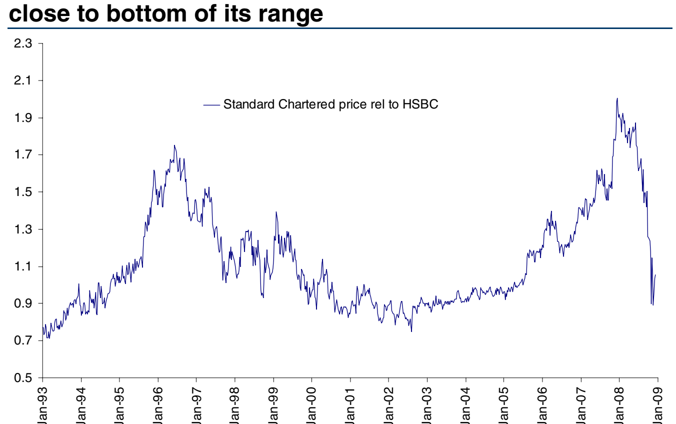
Figure 102: Standard Chartered price relative to HSBC—close to bottom of its range



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In Appendix 3 we show a full list of the European and US stocks we cover that have sales exposure to China.

(5) Infrastructure and how to play it

In recent months more governments have announced large fiscal stimulus packages and there is growing support for a Keynesian solution to the global downturn. Government spending is more efficient at boosting growth than tax cuts (as consumers are likely to save and some consumption would also leak into imports). At the same time, commitments to infrastructure should improve long-term productivity growth.

There are two important caveats to this theme.

(1) First, a sizable proportion of fiscal easing is directed at consumers (as they are the ones who vote). In the UK, for example, 83% of the fiscal stimulus measures announced in the Pre-Budget Report were primarily aimed at the consumer. Although details of many fiscal packages are limited, we estimate that roughly one third will be spent on infrastructure. This would equate to approximately US$400bn globally. In the US, we believe there will be a greater bias towards infrastructure spending than in other countries.

Figure 103: **Fiscal stimulus as % of GDP (as announced so far)**

	Fiscal Stimulus ($bn)	Fiscal Stimulus (% of national GDP)	Of which Infrastructure
China (Nov 2008)	585	12.0%	57%
US (Dec 2008)	500	3.6%	50%
Spain (Apr 2008)	14	1.0%	70%
Russia (Nov 2008)	100	5.8%	17%
EU (Nov 2008)	260	1.5%	35-50%
Japan (Oct 2008)	89	1.6%	29%
France (Dec 2008)	34	1.3%	40%
Germany (Nov 2008)	41	1.3%	15%
UK (Nov 2008)	26	1.1%	10%
South Korea	13.2	2.0%	25%

Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse estimates

(2) Second, a lot of the companies with exposure to infrastructure are short-cycle capital goods (which is one of our biggest underweights).

There is a case to focus on those infrastructure names that also have exposure to the US housing. US housing affordability is at its most attractive for nearly 30 years and we think by the end of Q1 home inventories will peak.

In Figure 104, we show a screen of valuations for European and US companies for which 20% or more of revenues are tied to infrastructure.

Of these, the following are cheap on HOLT and their P/B relatives are below their historical norm: Nucor, Philips (both are Outperform-rated), Ingersoll-Rand, Terex, Oshkosh.

Figure 104: European and US stocks with more than 20% of their business related to infrastructure and their valuations on our aggregate scorecard

			-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			Momentum -					
Name	% exposure	to what	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
First Solar Inc	c100%	revenue from gov programmes	16.2	151%	n/a	6.9	n/a	-0.1%	0.0%	10.2	-46.9	0.0	5.9	-0.3	1.5	55.6	1.5	Outperform
Sunpower	c100%	revenue from gov programmes	10.4	97%	n/a	2.7	n/a	-1.6%	0.0%	6.9	-52.9	1.0	-4.4	1.1	1.0	25.7	2.0	Neutral
Alstom	100%	sales related to infrastructure	10.2	95%	27%	5.8	226%	7.7%	2.6%	15.1	-35.9	2.0	-1.2	-0.5	1.0	-36.4	4.0	Neutral
Gamesa Corp	100%	exposure to wind	12.8	119%	30%	2.3	-20%	8.4%	2.3%	4.2	-39.4	2.0	-6.6	-0.2	0.5	21.7	2.5	Outperform
Terex Corp	75%	of sales from the non-rez/infrastructure	4.2	49%	-31%	0.7	-53%	32.9%	0.0%	-8.0	98.7	6.0	-13.3	-1.8	0.0	-6.7	7.0	Neutral
Quanta Services	60%	revenue from transmission& distrib	17.6	186%	n/a	1.5	n/a	2.2%	n/a	8.8	-62.7	0.0	-5.5	-2.5	0.0	55.6	0.0	Outperform
Nucor Corp	60%	of rev from constr-related applic	7.7	144%	-22%	1.6	-7%	17.0%	4.8%	-8.4	33.9	6.0	-1.2	-5.9	0.0	42.9	6.0	Outperform
Abb Ltd	43%	sales relate to utility spending	9.3	87%	-1%	2.8	23%	11.7%	3.8%	0.2	4.2	5.0	-5.3	-2.5	0.5	-12.0	6.5	Underperform
Stantec	35%	of revenues from US practice areas	13.0	n/a	n/a	2.7	n/a	7.0%	n/a	0.2	-26.7	2.0	4.5	-1.1	0.5	20.0	2.5	NR
Caterpillar	35%	of its revenues from non-rez and	8.6	100%	-7%	2.7	22%	11.9%	3.8%	-4.8	22.6	4.0	-1.8	0.9	0.5	-50.0	5.5	Neutral
Honeywell	34%	revenues from the aerospace market	7.9	95%	-9%	2.1	6%	14.4%	3.9%	0.1	4.4	5.0	-1.5	-1.9	0.5	22.2	5.5	Outperform
Ingersoll-Rand	32%	revenue from HVAC	5.7	67%	-31%	0.5	-66%	26.0%	4.6%	-5.9	25.5	7.0	-11.2	-2.6	0.0	-55.6	8.0	NR
CRH	30%	30-40% of build mat demand from infr	10.5	108%	39%	1.5	6%	9.0%	3.3%	-0.4	-21.1	2.0	-6.1	-0.8	0.0	46.7	2.0	Outperform
Siemens Ag	26%	power sales in Europe and the US (21%), lighting (5%)	8.7	90%	-8%	1.3	4%	7.7%	3.7%	3.4	-1.6	3.0	-3.3	0.1	1.0	20.0	4.0	Outperform
Philips Elec	23%	revenue from lighting manufacturing	10.5	109%	22%	0.8	-10%	13.0%	4.5%	2.9	6.5	3.0	-13.0	-3.6	0.5	-13.5	4.5	Outperform
Cooper Industries	23%	revenue from lighting manufacturing	9.4	88%	5%	1.7	25%	12.0%	3.5%	-0.7	-16.1	4.0	-4.4	-2.1	0.0	-46.7	5.0	Neutral
Hochtief Ag	22%	of EBITA US construction	11.6	123%	-24%	1.0	-28%	-12.3%	4.6%	3.8	-17.4	3.0	-3.1	2.4	1.0	57.9	4.0	Outperform
Oshkosh Corp	22%	of sales to US infrastructure/non-rez	4.1	48%	-54%	0.4	-81%	44.9%	n/a	-8.3	68.0	7.0	1.8	0.2	1.0	20.0	8.0	Neutral
URS	20%	revenues from U.S. infrastructure	13.2	140%	n/a	0.9	n/a	7.0%	0.0%	7.5	-61.7	1.0	6.8	-0.4	1.5	16.7	2.5	Outperform
Vinci	20%	EBIT from French roads & const	9.3	98%	25%	1.9	24%	7.2%	5.3%	1.8	-32.5	3.0	-1.8	-0.6	0.5	50.0	3.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

So where will the money go?

The top priority in many countries is green investments: lighting, smart buildings, alternatives (wind/solar) as well as railways.

US: As Credit Suisse's US capital goods analysts, Nicole Parent and Jamie Cook, highlighted in their report *The "New" New Deal: Use It or Lose It* (dated 9 December 2008), fiscal stimulus is likely to focus on energy, roads & bridges, schools, information superhighways and electronic medical records.

Energy-efficient lighting is a particular focus in the US. After all, 11% of total energy consumption is lighting, according to the IEA, and lighting accounts for about a third of energy usage in a commercial building. Energy-efficient lights can reduce energy intensity by 80%. The Department of Energy estimates that the payback period is typically about two years. Obama has highlighted this theme in his speeches: "We need to upgrade our federal buildings by replacing old heating systems and installing efficient light bulbs."

There is a strong emphasis on renewables. 12% of electricity is to come from renewables by 2012 (compared with 7% now) and 20% by 2025. 29 states already have minimum renewable energy requirements. This favours solar and wind. Credit Suisse's US analysts point out that solar is currently well above grid parity (ie, the cost of production is above the market price; indeed solar PV costs are nearly triple those of CCGT). Yet, they estimate that with a US$20pb carbon tax and a 50% fall in solar prices by 2010–11, solar could hit grid parity. Wind looks far more economic. With subsidies, it is about 20% cheaper than gas (without it is about 20% more expensive).

In Europe, wind is economic at a US$90pb oil price (with no subsidy), but with a subsidy the breakeven in the UK is US$50pb. Clearly the extent of the subsidy is a political issue and thus cannot be relied on to last forever. The re-opening of the credit markets may help make the financing of wind easier.

France: (we estimate c40% of total stimulus package spent on infrastructure): investment for state-owned rail, energy and postal companies, including a pledge to speed up projects such as a fast-speed train link in Western France; research, support for local authorities, 7% of fiscal stimulus package to help the construction industry (plans to build 100,000 new homes).

Germany: (we believe that c15% of the total stimulus package is spent on infrastructure): 9.4% spent on refurbishment programmes to reduce CO_2 emissions, 9.4% by local authorities on various projects, 6% over two-years for urgent transport projects.

EU: infrastructure projects (35–50% of total fiscal package) likely to focus on improving transport links between Eastern and Western Europe. Furthermore, we expect the EIB (European Investment Bank) funding will be increased by about €6bn to fund R&D focused low-emission, energy-efficient engines.

The EU economies—including Germany, France and Spain—have said they will invest some €21bn in new infrastructure over the next two years. This represents 7.5%, 2.6% and 7.5% respectively of 2007 civil and non-residential construction output. France has said it plans to guarantee loans on €16bn of PPP projects.

Figure 105: Selected additional European infrastructure fiscal stimulus
lc in millions, unless otherwise stated

Country	Measure	Amount (m local)	As % 2007 GDP	% 07 civil & non--res construction	% 2007 non-res & res construction	Timing
Germany	Investment in green buildings	3,000	0.1%	2.5%	1.4%	2009-2011
	Infrastructure for municipalities	3,000	0.1%	2.5%	1.4%	
	Rail, roads	3,000	0.1%	2.5%	1.4%	
	Waterways	1,000	0.0%	0.8%	0.5%	
France	Public housing projects	800	0.0%	0.7%	0.5%	2009
	Rail, roads and hospitals	1,400	0.1%	1.3%	0.9%	
	Renovation of public buildings	650	0.0%	0.6%	0.4%	
Spain	Public works incl infrastructure, building	8,000	0.7%	7.5%	5.0%	2009-2010
EU	Trans-European Transport (TEN-T) project	500				2009
	European total additional	**21,350**				
Australia(1)	Acceleration of works - committed funds	26,300	3.9%			
USA(2)	Infrastructure	136,000	1.0%	21.3%	15.3%	

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, © 2008 Reuters Limited. 1) Not additional spending. Funds already committed to nation-building agenda. 2) Amount proposed by the National Governors Association to Obama administration at 2nd Dec 08 meeting.

In **Japan**, we estimate that only 29% of spending will be on infrastructure. After the Koizumi administration, public works have become unpopular.

In **China**, we believe that most of the new spend will be on railways, highways, waterworks, power stations, environmental related (scrubbers, wind, solar, nuclear). Credit Suisse's China economists estimate that at least 57% of the fiscal stimulus package is likely to be spent on infrastructure. This includes public transportation and power (47%), rural living and infrastructure (10%), public housing (7%), earthquake reconstruction (26%).

The top picks from Credit Suisse analysts are:

In the **US—***infrastructure:* Caterpillar, Deere, URS; *energy*: Cooper Industries, Quanta Services, General Electric; a*irport infrastructure*: Honeywell International; *electronic medical records*: General Electric. We show valuations of these US stocks in Figure 106.

Figure 106: US infrastructure plays: Top picks

Name	P/E (12m fwd) Abs	P/E rel to Industry	P/E rel to mkt % above/below average	P/B Abs	P/B rel to mkt % above/below average	Yield (08e) FCY	Yield (08e) DY	HOLT Implied CFROI less 5-year average	HOLT Price, % change to best	Valuation score	Momentum CFROI	Momentum 1m EPS	Momentum 3m EPS	Momentum 3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Caterpillar Inc	8.6	100%	-7%	2.7	22%	11.9%	3.8%	-4.8	22.6	4.0	-0.6	0.0	-1.8	0.9	0.5	-50.0	5.5	Neutral
Deere & Co	8.3	98%	-2%	2.1	38%	6.7%	2.9%	-1.9	20.9	5.0	2.7	0.0	-0.3	-0.2	0.5	-17.7	6.5	Outperform
Urs Corp	13.2	140%	n/a	0.9	n/a	7.0%	0.0%	7.5	-61.7	1.0	3.0	5.7	6.8	-0.4	1.5	16.7	2.5	Outperform
Cooper Industries	9.4	88%	5%	1.7	25%	12.0%	3.5%	-0.7	-16.1	4.0	-1.4	-3.6	-4.4	-2.1	0.0	-46.7	5.0	Neutral
Quanta Services	17.6	186%	n/a	1.5	n/a	2.2%	n/a	8.8	-62.7	0.0	-0.4	-9.2	-5.5	-2.5	0.0	55.6	0.0	Outperform
General Electric	11.3	118%	8%	1.5	-40%	2.7%	6.9%	-1.5	-16.2	3.0	-2.6	-2.6	-13.8	-1.6	0.0	-46.7	4.0	Neutral
Honeywell Int	7.9	95%	-9%	2.1	6%	14.4%	3.9%	0.1	4.4	5.0	0.8	-0.2	-1.5	-1.9	0.5	22.2	5.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

We show details of all the US stocks exposed to the Infrastructure spend theme in Figure 107.

Figure 107: US stocks that are likely to be beneficiaries of the US infrastructure spend

Stocks	Sector	% exposure	of what	comment
Honeywell	Electr Equip	34%	revenues from the aerospace market	Honeywell offers enhanced synthetic visions systems, advanced visualization and safety including runway advisories, and advanced navigation procedures
United Technol	Electr Equip	9%	of rev from integrated aerospace systems	potential for an infrastructure stimulus is a significant positive for machinery, E&C and aerospace controls companies. Plus 7% revenue from HVAC (Heating Ventilation Air Conditioning)
GE	Electr Equip	2%	revenue from lighting manufacturing	Also GE Healthcare is the largest healthcare IT company in the world
Cooper Ind	Electr Equip	23%	revenue from lighting manufacturing	
Schneider	Electr Equip	14%	revenue from lighting manufacturing	
Philips	Household Dur	23%	revenue from lighting manufacturing	
Caterpillar	Machinery	35%	of its revenues from non-rez and infrastructure markets	roughly half of this is tied to the U.S. market. CAT has 27% mkt share of LTM construction equipment sales (# 1)
Deere & Co.	Machinery	15%	of its revenues from the U.S. non-rez/infrastructure markets	4% mkt share in LTM construction equipment sales
Terex Corp	Machinery	75%	of sales from the non-rez/infrastructure	Terex has a large presence overseas (70%), though we estimate ~15% of the company's total sales come from U.S. infrastructure construction. TEX is # 3 largest manufacturer of construction equipment (9% mkt share)
H&E Equip Serv	Machinery	90%	of its revenues from the energy/non-residential/infrastructure markets	Of this 90%, 50% is tied to energy (oil and gas/mining) w/ the remaining 40% being split among non-rez and infrastructure spending. ~20% of the company's sales come from U.S. infrastructure construction. H&E is the only company that derives 100% of its business from construction activity in the U.S.
Oshkosh	Machinery	22%	of sales exposure to the U.S. infrastructure/non-rez	
Granite Constr	Engin Const	100%	exposure to US infrastructure	42% of rev from highway/roads. Airports/bridges/dams/rapid transit account for 26% of the company's business
Jacobs Engin	Engin Const	15%	sales from U.S. infrastructure/non-rez	Jacobs has a significant amount of experience with engineering and building highly technical structures (schools).
Fluor	Engin Const	10%	sales from the U.S. infrastructure	Fluor has the ability to both design and construct several types of infrastructure projects including roads, bridges and tollways
URS	Engin Const	20%	revenues from U.S. infrastructure	combination of URS's design capabilities and Washington Group's construction competencies makes it one of the more attractive infrastructure plays
AECOM	Engin Const	15%	sales from the transportation infrastructure	
Shaw Group	Engin Const	5-10%	sales from U.S. infrastructure	has experience with levee systems, bridges and water treatment plants.
Stantec	Engin Const	35%	of revenues from US practice areas	Those practice areas are predominately focused upon: environmental applications, airports, rail, bridges, roadways, transit, traffic, industrial areas
Nucor	Steel	60%	of revenue from construction-related applications	vs 20% at most for competitors. US steel producers should be a beneficiary...with ~30% of total US steel consumption going into construction-related applications. Nucor clear beneficiary
SunPower	Solar Energy	c100%		
First Solar	Solar Energy	c100%	of revenues for solar companies are government prorgrammes, so solar stocks are very sensitive to changes in subsidies and stimuli. SPWR US exposure is 30%, FSLR 10% in 2009	Obama's intention to invest in "new energy infrastructure"- wind/solar/transmission would benefit. Potentially regulated utilities allow higher ROEs for renewable projects. These solar companies (SPWR and FSLR) are best engaged with utilities
Cemex	Cement	15%	of EBITDA is generated in the US	Public works sector accounts for about 50% of the sales in the US
Hexcel Corp	Spec Chem	12%	of sales wind power (alternative energy)	alternative energy has wind power biz
Acuity	Lighting manuf	85%	revenue from lighting	lighting is expected to be a key beneficiary of the investment spend
Hubbell	Lighting manuf	22%	revenue from lighting manufacturing	
Ingersoll Rand		32%	revenue from HVAC	
Johnson Controls	Auto parts	13%	revenue from HVAC	
Quanta Serv	Engin Constr	60%	revenue from transmission and distribution spending	

Source: Credit Suisse US capital goods team, Company data, Credit Suisse estimates. HVAC :Heating Ventilation Air Conditioning

In **China:** stocks most exposed to railways are: China Railway, China Railway Construction, China Southern Locomotive (railway equipment manufacturers), Zhuzhou Electric (railway equipment manufacturers), China Communication Construction, China Railway Erju.

Figure 108: Stocks most exposed to China's railways

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			-------- Momentum -----------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
China Railway Cons	20.6	217%	n/a	2.7	n/a	-1.7%	0.8%	7.9	-53.0	0.0	3.5	-0.3	-8.4	-0.2	0.5	15.8	0.5	Outperform
China Railway Grou	17.9	188%	n/a	1.7	n/a	-1.0%	0.6%	4.1	-55.1	0.0	-1.4	-4.6	-33.0	-0.2	0.0	0.0	0.0	Outperform
Zhuzhou Csr Times	13.6	127%	n/a	2.0	n/a	1.1%	2.6%	3.5	-61.5	0.0	-0.8	-0.3	-1.8	0.5	0.5	25.0	0.5	NR
China Comm Constr	15.0	158%	n/a	2.9	n/a	-2.3%	1.1%	2.7	-22.2	0.0	0.2	-2.2	-15.3	-3.8	0.5	20.0	0.5	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

In Figure 109 we show valuations of environmental control system stocks.

Figure 109: Environmental control system stocks and their valuations on our aggregate scorecard

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			-------- Momentum -----------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Shaw Group Inc	7.3	77%	-15%	1.1	29%	10.2%	0.0%	-2.0	80.2	5.0	5.7	0.2	0.6	-0.2	1.5	-23.1	7.5	Outperform
Mcdermott Intl Inc	4.6	48%	n/a	1.3	n/a	17.0%	0.0%	-8.9	102.9	6.0	-2.7	-11.4	-22.6	-3.6	0.0	23.1	6.0	Neutral
Foster Wheeler Ltd	6.0	63%	n/a	3.7	n/a	14.5%	0.0%	1.9	20.0	4.0	3.8	0.0	0.4	0.5	1.5	80.0	5.5	NR
Alstom	10.2	95%	27%	5.8	226%	7.7%	2.6%	15.1	-35.9	2.0	10.8	0.2	-1.2	-0.5	1.0	-36.4	4.0	Neutral
Urs Corp	13.2	140%	n/a	0.9	n/a	7.0%	0.0%	7.5	-61.7	1.0	3.0	5.7	6.8	-0.4	1.5	16.7	2.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

In **Europe:** Credit Suisse's European infrastructure analyst, Robert Crimes' preferred pick to play the stimulus packages is Vinci, which has a very strongly positioned, well managed French construction business, some exposure to the US road construction market and experience in developing European PPPs. Vinci has an IRR of 15.8% (on concession assets) and 2009E FCF yield of 13%. As a 'regulated' utility, it has underperformed its peer group significantly. His second pick is Hochtief (according to his estimates, US construction is 22% of Hochtief's 2009E EBITA).

The **European building/ construction** team would play this theme via CRH, as it believes that the company's US business will benefit from the US' planned infrastructure projects. Credit Suisse analyst Harry Goad estimates that CRH generates c15% profit from US infrastructure. (He also notes that 30–40% of global building materials demand comes from infrastructure).

European capital goods analyst Simon Smith would highlight Philips.

Figure 110: European stocks expose to infrastructure spending theme

Stocks	Sector	% exposure	of what	comment
Philips	Household Dur	23%	revenue from lighting manufacturing	Accelerated phasing out of incandescent bulbs and replacement of public lighting with efficient lighting solutions could be positive. If healthcare spending initiatives have a positive influence on medical equip it could help Philips Healthcare operations, which are focused in the US and Europe and account for 45% of sales
Siemens	Electr Equip	26%	power sales in Europe and the US (21%), lighting (5%)	Positive for China power sales (3%). Healthcare businesses (20%)
Schneider	Electr Equip	14%	revenue from lighting manufacturing	20% of Schneider's products relate to energy efficiency, implying that that 14% of sales in US and EU would be exposed to this theme. Schneider's business also focuses on building control, UPS and Low voltage distribution
Alstom	Ind Machin	100%	sales related to infrastructure	rail investment (33%), power spending in China (3%) and 45% of power spending in US and Europe
ABB	Electr Equip	43%	sales relate to utility spending	China (5%) and potentially some benefits in Europe and US (25%)
Vinci	Multi-Industry	20%	of EBIT from French roads & construc	very strongly positioned, well managed French construction business, some exposure to the US road construction market and established experience in developing European PPPs
Hochtief	Multi-Industry	22%	of EBITA US construction	
CRH	Building Mat & Constr	30%	infrastructure accounts for 30-40% of building materials demand	US businees is clear beneficiary
Gamesa	Wind	100%	exposure to wind	
AIXTRON	Semis Equip	10%	of business is lighting	80% of business is LED but LED lighting will not achieve parity for 2 years. (5-10% Lighting, 15% Automtive, 30% Handset, 50% Displays); Other 20% is DRAM. The exposure to Lighting might increase with EU banning incandescent lighting from Sep 09

Source: Credit Suisse European capital goods team, Utilities team, Building Construction team Company data, Credit Suisse research

(6) Short asset-life industries are better suited to deal with deflation

There is a good deal of evidence that industries with a short asset life have endured a more challenging pricing environment in the past ten years. Figure 111 and Figure 112 show that there is some relationship between asset life and pricing power. Utilities, transportation, energy and materials have not only long asset lives but they have also had pricing power. Technology, retailing, consumer durables and apparel and telecom services have lower asset lives and the ten-year CAGR of their end prices was negative.

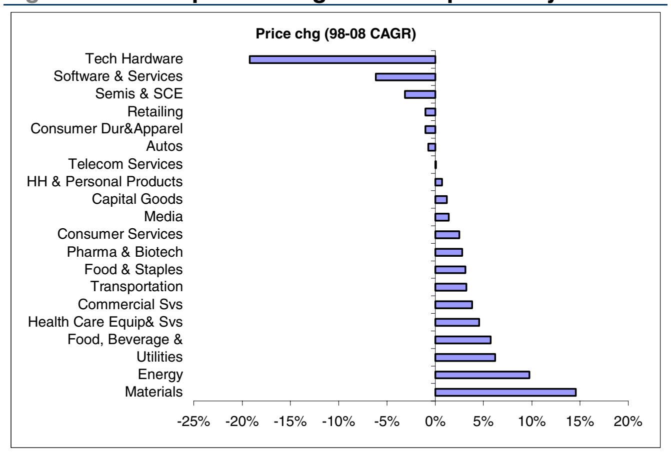
There are two probable reasons for this:

First, short asset-life companies are agile in that they are able to adjust their capacity to changes in demand and thus pricing is generally not an issue. That is not the case for long asset life companies.

Second, short asset-life companies have fewer barriers to entry (long asset-life companies, for example transportation, miners or utilities have to install the necessary infrastructure and be involved in projects with very long lead times). This means that short asset-life companies have faced more intense global competition, especially from emerging markets.

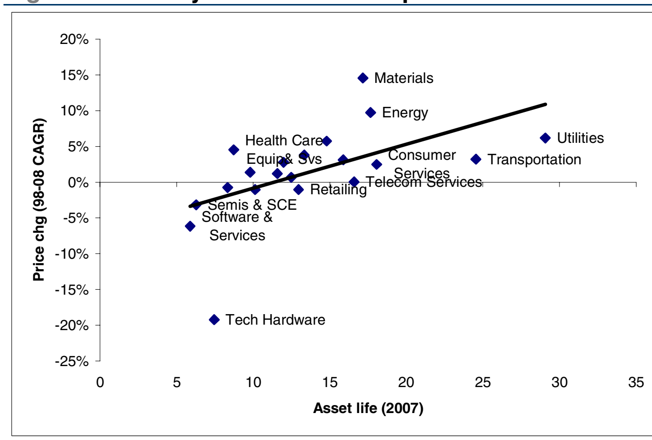
The net result is short asset-life companies are used to global deflation.

Figure 111: End-price change over the past ten years



Source: Credit Suisse HOLT, Credit Suisse research

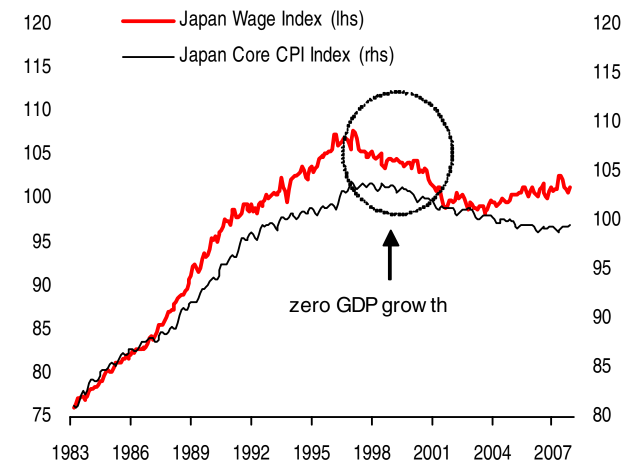
Figure 112: Ten-year CAGR in end-price versus asset life



Source: BLS, Credit Suisse HOLT, Credit Suisse research

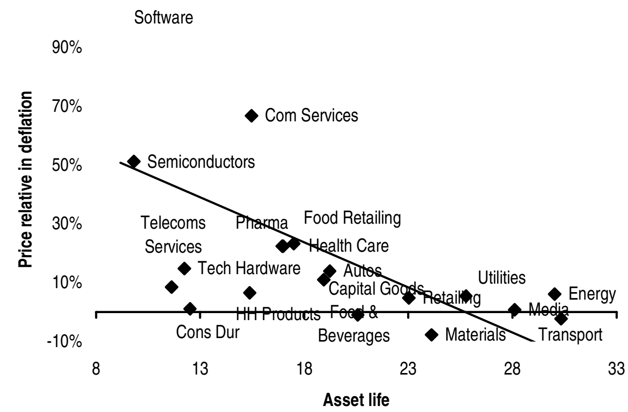
Over the past 30 years, only Japan has experienced a protracted period of deflation. We define this as a period of falling core prices, falling wages and no growth in real terms (from November 1997 to June 2002). During this period, sectors with a shorter asset life have outperformed the market, as shown in Figure 114.

Figure 113: Japan deflation: November 97–June 2002



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 114: Japan sectors in deflationary period



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We screen for companies in short asset-life sectors. Within those sectors we identify companies that have maintained consistent profit growth, ie, have seen positive profit growth in at least eight out of ten years.

Figure 115: European companies in short asset-life industries that have consistently delivered positive earnings growth in the past ten years, Outperform ratings or cheap on HOLT

		-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			-------- Momentum ----------							
Name	EPS growth, 10 year CAGR	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Sap Ag	16%	14.1	128%	-20%	5.6	-17%	6.7%	1.8%	5.6	-26.6	4.0	6.4	-1.1	-5.2	-2.4	0.5	-4.8	5.5	Outperform
Indra Sistemas Sa	23%	13.6	111%	12%	3.9	12%	6.6%	3.8%	-1.0	-2.7	3.0	1.9	-0.2	-0.1	0.0	0.5	12.0	3.5	Outperform
Logitech Intl	40%	9.2	82%	-2%	2.4	-29%	10.7%	0.0%	-8.6	19.0	6.0	-4.4	-3.8	-17.5	-9.8	0.0	-20.0	7.0	Neutral
Rps Group	19%	5.9	50%	n/a	1.0	n/a	15.8%	3.1%	-9.4	81.5	7.0	2.5	-0.5	-0.8	1.4	1.0	23.1	8.0	NR
Novartis Ag	8%	11.0	107%	-3%	2.0	-12%	7.6%	3.7%	-5.7	47.7	5.0	1.2	2.3	10.9	13.4	2.0	12.5	7.0	NR
Sanofi-Aventis	22%	7.9	77%	-27%	1.4	-6%	10.5%	4.7%	-5.9	31.0	7.0	-2.2	-1.7	-1.8	0.1	0.5	6.7	7.5	NR
Qiagen Nv	23%	17.9	n/a	3%	2.2	-32%	4.6%	0.0%	8.5	-71.1	1.0	3.3	0.2	-0.3	-0.6	1.0	57.9	2.0	Outperform
Rhoen-Klinikum Ag	13%	12.7	153%	15%	2.0	13%	1.6%	2.0%	-0.7	2.3	3.0	0.4	-0.1	-1.1	0.3	1.0	36.4	4.0	NR
Galenica Ag	19%	10.3	125%	20%	4.3	82%	11.8%	2.4%	1.5	17.7	3.0	11.5	-0.4	0.0	-0.7	0.5	11.1	3.5	NR

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

In Appendix 4 we show the same screen for the US. We find that the following names are outperform rated or cheap on HOLT: Apple, Citrix, Dell, Amphenol and Cardinal Health.

(7) Style: Buy high yield and big cap; mild leverage is OK

We believe that the best-performing styles over 2009 will be big cap and high dividend yield.

Dividend yield

Dividend yield was the best-performing style in the last bear market and the first year of the last bull market and has also outperformed in the last four periods of falling markets.

Figure 116: **High dividend yield stocks outperformed in the last bear market and the start of the last bull market**

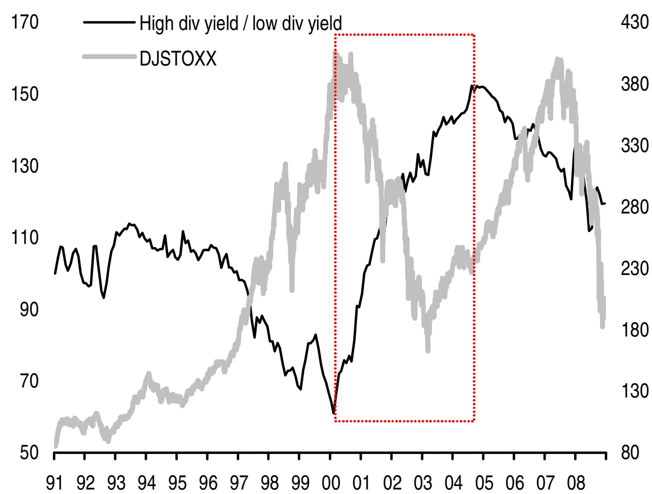

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Figure 117: **Annualised performance of the dividend yield style in falling markets**

	Market peak	Market trough	Annualised relative performance	Annualised relative performance (ex financials)
High DY / market	Jun-92	Oct-92	1.7%	3.4%
	Feb-94	Mar-95	2.0%	4.3%
	Jul-98	Oct-98	17.4%	7.6%
	Mar-00	Mar-03	14.2%	13.9%
	Jul-07	Nov-08	-7.0%	3.9%
	Average ex 2008		*8.8%*	*7.3%*

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There are three reasons for focusing on dividends. First, with the worst earnings momentum on record we believe investors will focus on dividends. Second, and most importantly, we suspect the selling point for retail investors will be yield pick-up, given that interest rates are at historical lows. Third, dividend yields are typically a company's best estimate of mid-cycle earnings. We believe capital spending will be reduced to maintain the dividend.

We can see that the market is not paying a premium for high-yielding stocks despite the obvious attractiveness of the yield pick-up, with the yield gap in the US and UK being at its highest since the 1950s.

Figure 118: **High dividend yield stocks' P/E relative to low-yield stocks is at average levels**

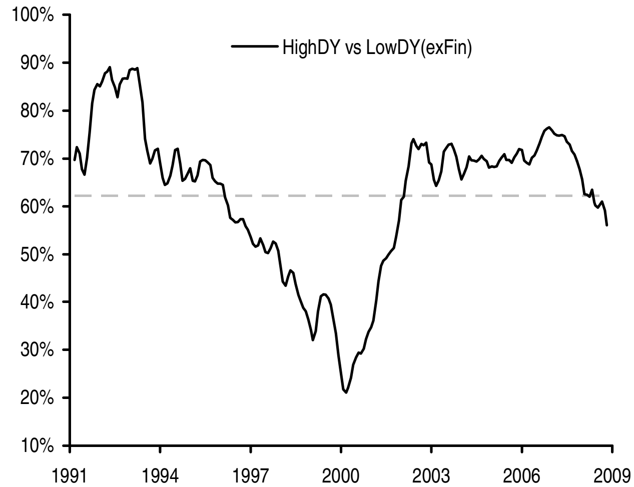

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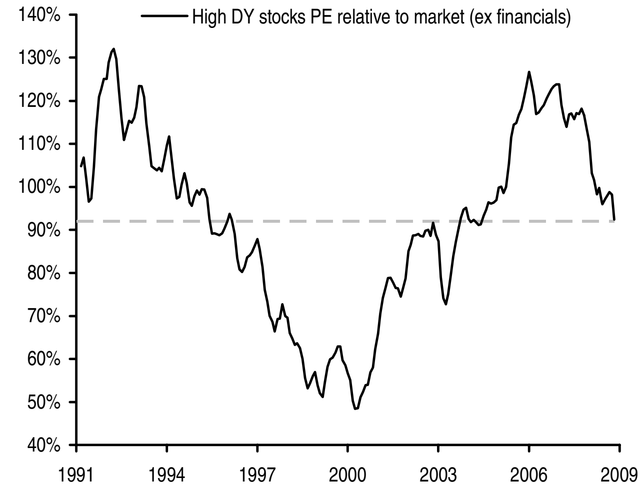
Figure 119: **High yield stocks' P/E relative to the market ex financials is in line with its average**



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We suspect that the market has become too pessimistic on dividends. Credit Suisse's Derivatives Strategy team notes that the dividend swaps market is pricing in a decline in dividends of 35% in 2009E and another 36% in 2010E for the Euro Stoxx 50.

Even if there is a further 27% fall in European earnings and assuming that dividends are held constant, dividend cover would fall to be in line with the trough of the early 1990s at 1.7x.

Figure 120: **Dividend cover would fall to 1993 low if dividends were maintained and earnings fall 27% (our forecast for Europe)**

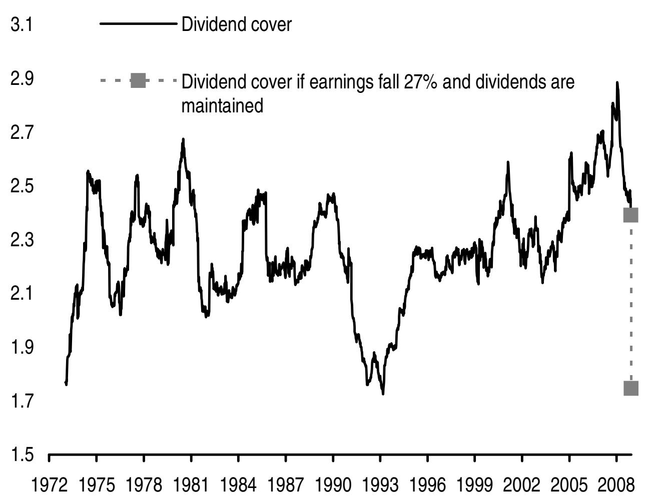

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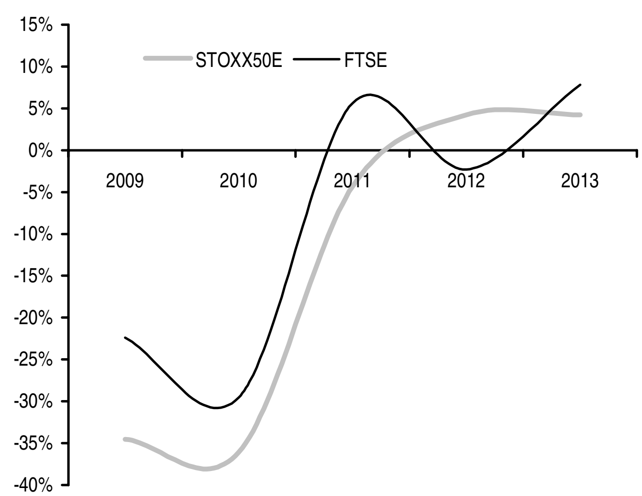
Figure 121: **Year-on-year growth for dividends, as implied by futures markets, is heavily negative in 2009E and 2010E**



Source: Credit Suisse Derivatives Strategy Team

In Figure 122 we show Outperform-rated stocks that are forecast to at least maintain dividends at 2007 levels to 2010, with a dividend yield above 5% (and at least 1% above the bond yield) and a CDS (if available) below the market median of 150 bps.

Figure 122: European Outperform-rated stocks with expected rising dividends, dividend yield above 5% and a CDS spread (if available) below the market median

Company	FY1 DPS growth	FY2 DPS growth	FY3 DPS growth	2008e DY	CDS Spread	CS Rec
ACCOR	1.8%	2.4%	6.4%	5.0%	148.0	Outperform
BBV.ARGENTARIA	4.1%	3.9%	5.1%	9.1%	101.8	Outperform
BRITISH LAND	5.8%	3.5%	2.9%	7.1%	n/a	Outperform
DEUTSCHE TELEKOM (XET)	2.6%	3.7%	4.8%	7.3%	140.0	Outperform
E ON (XET)	13.1%	14.8%	11.8%	5.9%	122.8	Outperform
HENNES & MAURITZ 'B'	11.1%	7.4%	10.8%	5.1%	n/a	Outperform
KONE 'B'	26.2%	2.4%	1.2%	5.4%	n/a	Outperform
MEGGITT	10.6%	7.7%	7.7%	6.1%	n/a	Outperform
SOCIETE GENERALE	115.6%	51.0%	12.3%	5.4%	106.7	Outperform
TNT	1.2%	4.7%	3.3%	6.4%	145.0	Outperform

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Figure 123: US Outperform-rated stocks with expected rising dividends, dividend yield above 5% and a CDS spread (if available) below the market median

Company	FY1 DPS growth	FY2 DPS growth	FY3 DPS growth	2008e DY	CDS Spread	CS Rec
AMER.ELEC.PWR.	4.4%	6.1%	5.7%	5.5%	87.5	Outperform
FIRSTENERGY	8.5%	6.5%	6.1%	4.0%	139.6	Outperform
FPL GROUP	6.7%	7.4%	4.3%	3.8%	n/a	Outperform
HJ HEINZ	9.2%	6.0%	2.3%	4.5%	119.6	Outperform
HONEYWELL INTL.	10.0%	0.9%	4.5%	3.8%	141.9	Outperform
INTEL	22.7%	9.3%	1.7%	3.7%	n/a	Outperform
LINEAR TECH.	10.3%	2.3%	8.0%	3.8%	n/a	Outperform
LORILLARD	82.4%	25.3%	6.3%	5.6%	84.0	Outperform
NORTHROP GRUMMAN	6.1%	8.3%	5.3%	3.9%	84.5	Outperform
PG&E	8.3%	6.4%	6.0%	4.2%	n/a	Outperform
PUB.SER.ENTER.GP.	12.8%	9.1%	9.0%	4.5%	63.5	Outperform
WELLS FARGO & CO	10.2%	5.4%	2.2%	4.9%	140.1	Outperform

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We also note that Alleanza, BBVA, Santander, Intesa Sanpaolo, Snam Rete Gas and Telekom Austria all have a dividend yield more than 1% above their respective government bond yields and a CDS spread lower than their respective sovereign debt. In the US Public Service Enterprise Group also meets this criteria.

Big cap

We have five main reasons for preferring big cap to small cap.

(1) We show that large cap (proxied by the S&P500) tends to outperform small cap (S&P600) when lead indicators fall. However, as we can see from Figure 124 and Figure 125 large cap should have done a lot better given the fall the fall in lead indicators.

Figure 124: Slump in new orders should support outperformance of big cap

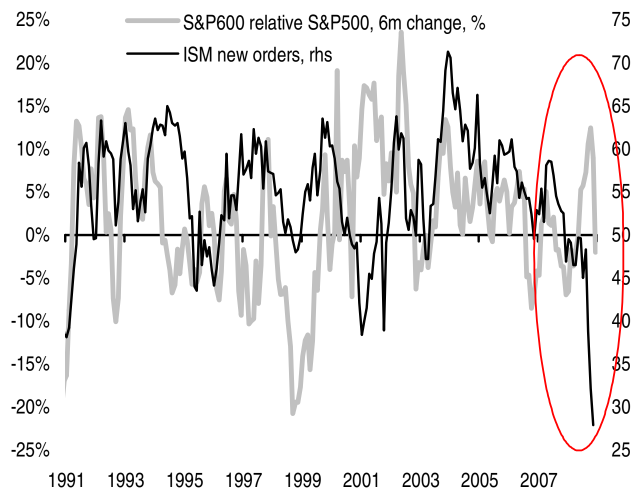

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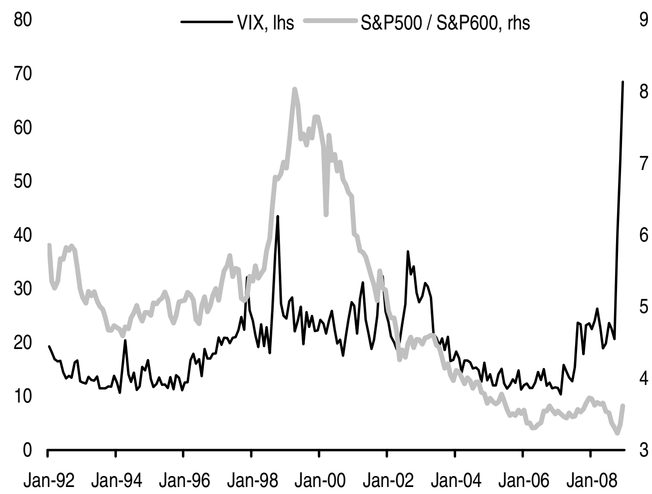
Figure 125: Big cap should have outperformed, given the rise in volatility



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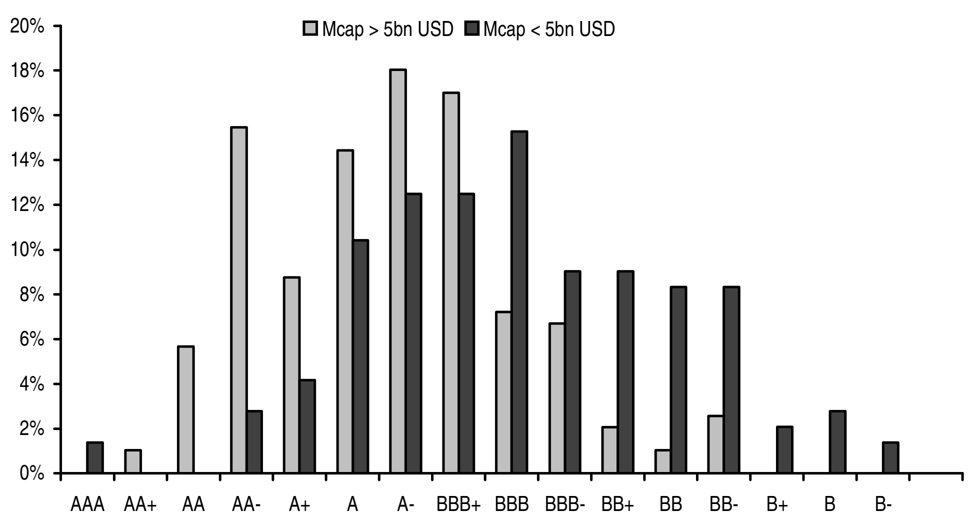
(2) In the past big cap have also outperformed when volatility has been high. This is because when volatility is high and credit spreads are high there is extreme macro-economic volatility. In this environment big cap implicitly benefit as their business models tend to be more diversified. In addition, the credit ratings tend to be higher on big cap than for small cap (as shown in Figure 126).

Figure 126: Credit ratings for big cap tend to be higher



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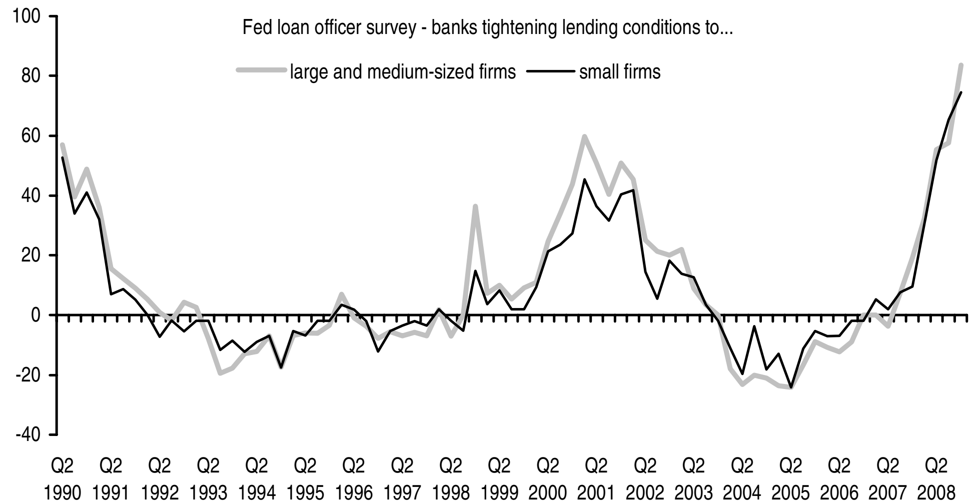
(3) Although the Fed loan officer survey shows that lending conditions are being tightened across the board, we believe that large companies have much better access to credit than small companies. Indeed, big cap companies can often access Federal lending programmes (with the Fed buying unsecured CP).

Figure 127: Fed loan officer survey shows banks are tightening lending conditions to both small and large companies



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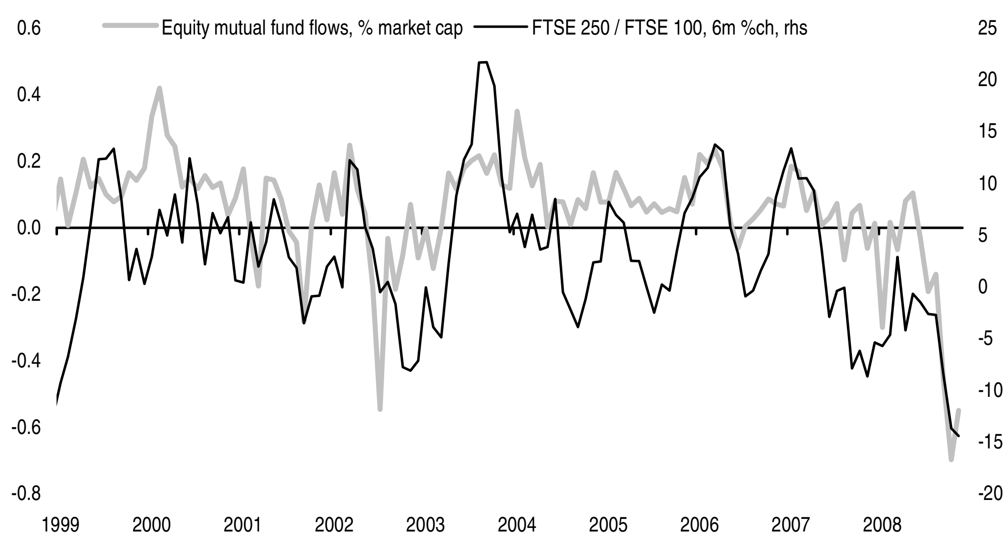
(4) We believe that the funds' flow over the past five years had benefited small cap companies. However, with the demise of hedge funds, investors have been reminded of the illiquidity discount that small caps should trade on. With markets down heavily it has been very difficult for investors to sell their illiquid stakes. With a high degree of macro uncertainly both investors and fund mangers demand liquidity.

Figure 128: Equity fund outflows have hit the relative performance of small cap



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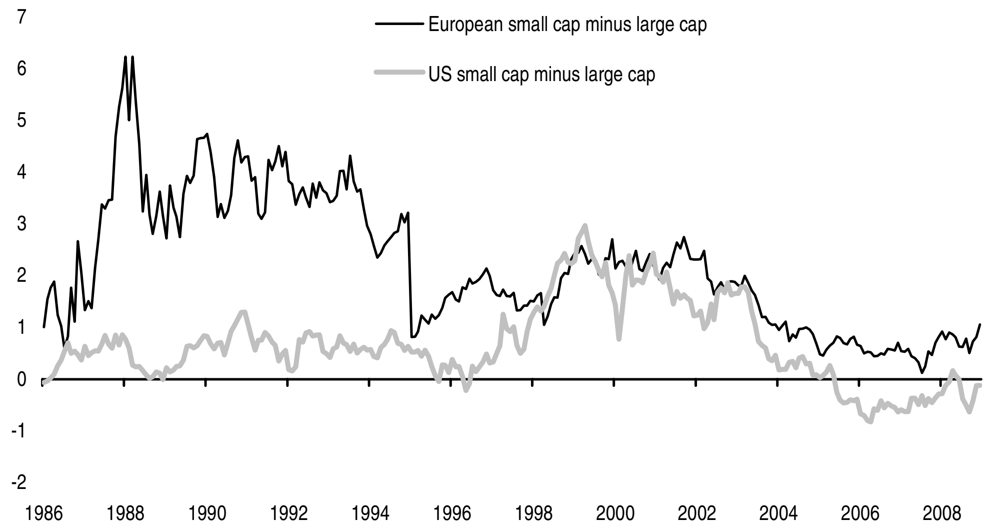
(5) Valuation. Based on HOLT, we find that small cap stocks have a discount rate that is similar to large cap. This makes no sense at all given the higher liquidity and investment risks in small cap.

Figure 129: Discount rates for small cap are close to large cap



Source: Credit Suisse HOLT

Nor are large cap expensive relative to small cap on P/E in the US or the UK.

Figure 130: US large cap are cheap relative to small cap

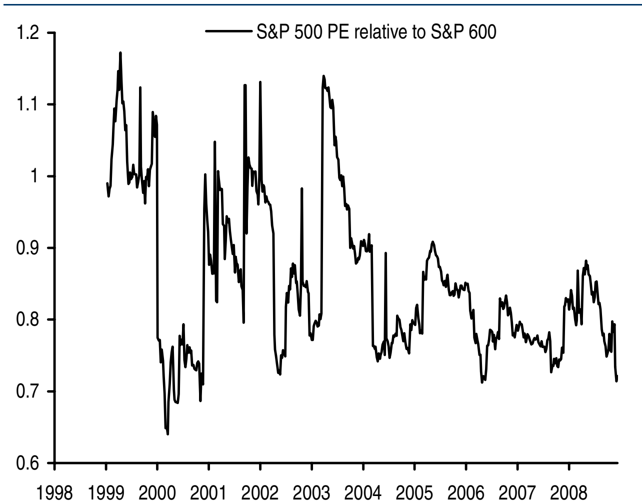


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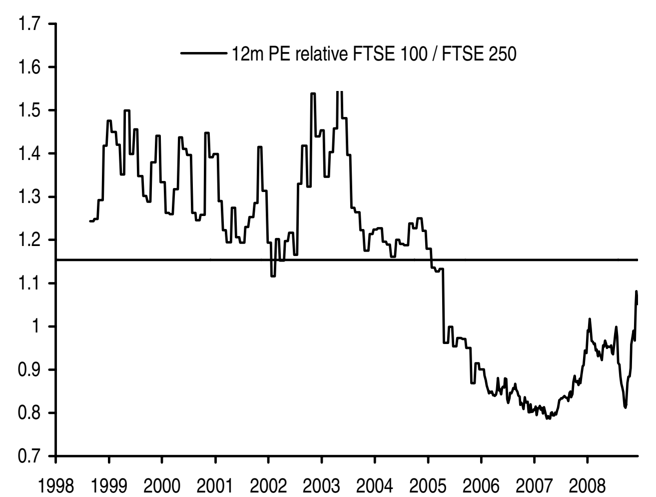
Figure 131: FTSE 100 trades below its average relative to the FTSE 250



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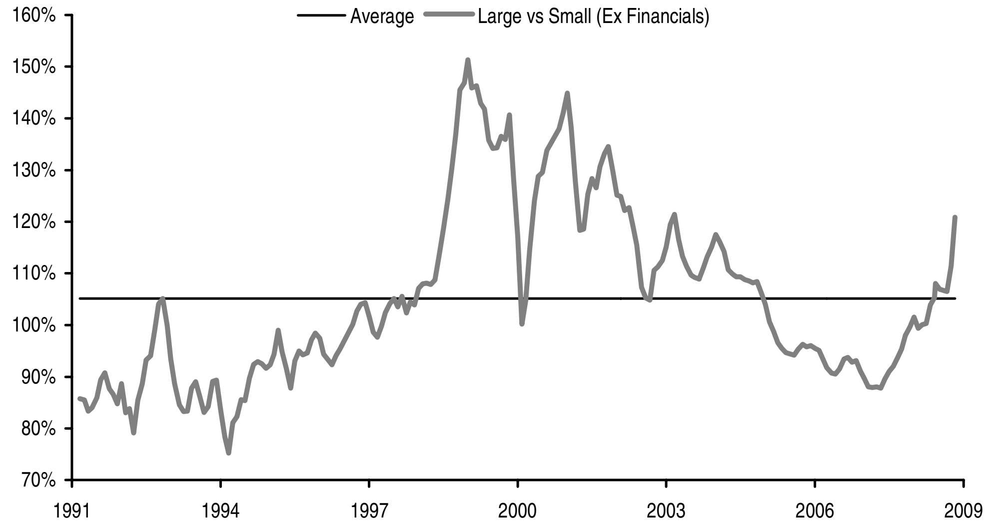
In Continental Europe the P/E premium of big cap relative to small cap is 30% compared with an average of 5%. The premium reached 45% in the last bear market.

Figure 132: **Continental European big cap P/E relative to small cap P/E**



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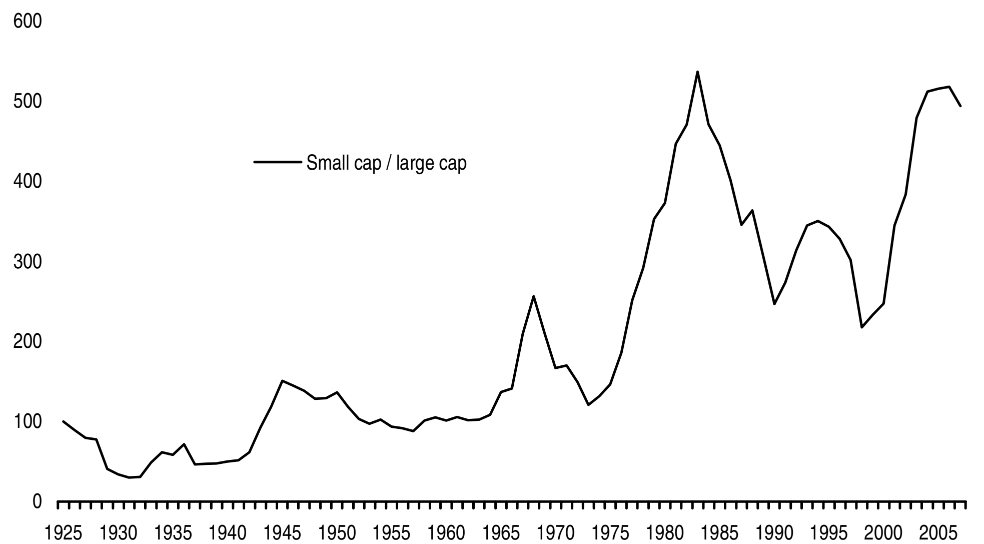
Finally, we can see the long-run performance of small cap relative to large cap in the US.

Figure 133: **Long-run chart of US small caps / large cap price performance**

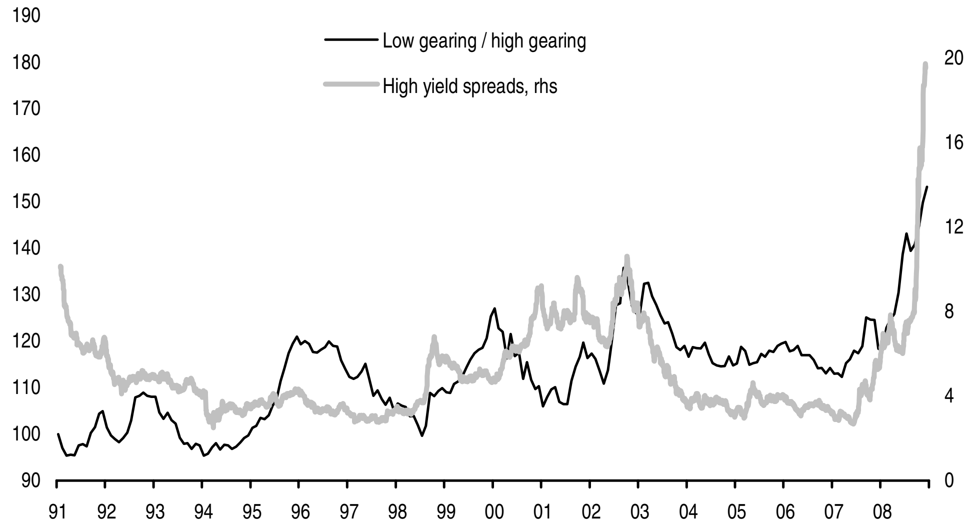


Source: Ibbotson, Credit Suisse research

Leverage

While the credit market remains the focus of attention, it is unsurprising to see that low leverage companies have outperformed those with high leverage as credit spreads have widened.

Figure 134: **Performance of low leverage relative to high leverage stocks versus high yields spreads**



Gearing defined as long-term loans + short-term loans – cash + preferred equity
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Despite the 80% outperformance of low leverage over the past year, valuation has yet to reach extreme levels.

Figure 135: **Low gearing P/E relative to high gearing**

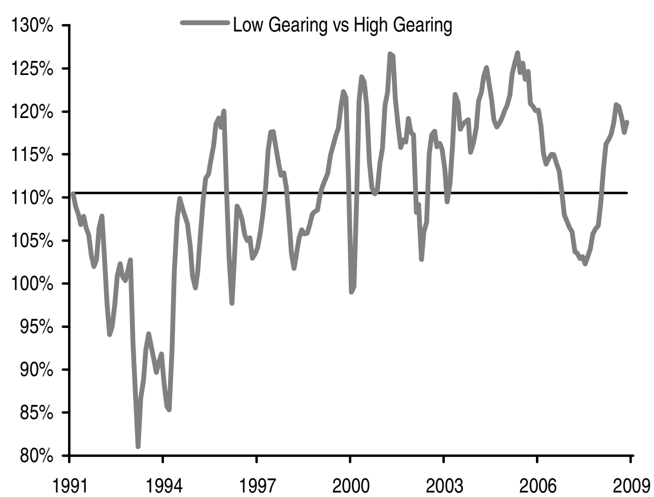

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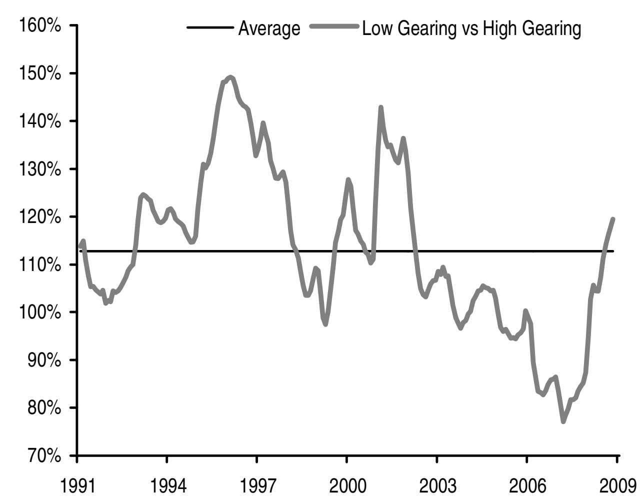
Figure 136: **Low gearing P/B relative to high gearing**



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We believe that credit offers extraordinary value, with implied default rates well above those seen in previous recessions and in the 1930s. We would expect spreads to narrow. This does not necessarily mean we should be buying high leverage and selling low leverage, but it does mean that we have to be more selective. We still want to avoid companies with high leverage, low FCF yield in cyclical sectors, as shown in Figure 137.

Figure 137: European high leverage, low FCF and low DY cyclical stocks

Name	Net Debt as a % of Mcap	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT		Valuation score	- Momentum ----		Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
		Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best		3m EPS	3m Sales				
Areva	73%	13.6	127%	n/a	1.9	n/a	1.6%	2.5%	7.3	-41.2	0.0	-17.2	-0.9	0.5	-77.8	1.5	NR
Fraport Ag	90%	14.5	95%	31%	1.0	13%	-7.6%	4.3%	3.5	-53.9	1.0	-2.3	-1.8	0.0	-17.2	2.0	Underperform
Impregilo Spa	74%	7.5	79%	-7%	0.9	46%	-1.6%	0.8%	6.4	-25.9	2.0	-25.1	-2.4	0.0	77.8	2.0	NR
Kingfisher	142%	13.6	103%	55%	0.6	-49%	-1.2%	3.9%	2.2	-84.3	2.0	-2.6	-1.4	0.0	-69.2	3.0	Neutral
Air France-Klm	242%	8.1	47%	15%	0.2	-52%	-9.9%	3.1%	2.4	-94.6	2.0	-20.6	-1.7	0.0	-30.0	3.0	NR
Abengoa	310%	8.1	85%	-9%	1.6	-2%	-63.1%	1.5%	3.5	-186.0	3.0	-1.2	-1.4	0.0	12.5	3.0	NR
Tui Ag	415%	8.5	71%	9%	1.0	-11%	-0.1%	3.5%	2.0	-87.8	2.0	-22.5	-7.8	0.5	-42.9	3.5	NR
Arriva	226%	8.4	74%	28%	1.2	11%	-1.4%	4.8%	3.6	-67.3	2.0	0.6	0.8	1.5	0.0	3.5	NR
A.P. Moller-Maersk	181%	8.0	150%	-23%	1.0	-85%	-13.6%	2.2%	-1.6	-7.3	3.0	-6.0	-0.8	0.5	14.3	3.5	NR
Autogrill Spa	426%	11.7	97%	-4%	3.0	-47%	3.9%	4.3%	4.7	-156.1	4.0	-11.0	1.0	0.5	22.2	4.5	NR
British Airways	133%	-38.6	-225%	-678%	0.6	-36%	3.2%	1.7%	0.6	-27.7	3.0	NM	0.3	1.0	-14.3	5.0	NR
Holcim	100%	9.3	96%	28%	1.0	0%	2.0%	4.1%	-1.0	13.6	4.0	-12.1	-1.8	0.0	-33.3	5.0	Underperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research, Credit Suisse research

Figure 138: US high leverage, low FCF and low DY cyclical stocks

Name	Net Debt as a % of Mcap	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT		Valuation score	----------- Momentum -------------				Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
		Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best		CFROI	1m EPS	3m EPS	3m Sales				
Marriott Intl Inc	105%	12.5	104%	9%	4.2	101%	1.0%	2.0%	3.9	-46.1	0.0	-0.7	-1.8	-9.4	-1.8	0.0	0.0	0.0	NR
Pulte Homes Inc	142%	-9.6	-66%	-270%	0.9	5%	-41.9%	0.9%	8.2	-48.7	2.0	-7.6	NM	NM	-2.4	0.0	-37.5	3.0	Neutral
Amr Corp/De	800%	4.7	27%	-35%	2.9	265%	-29.3%	0.0%	4.3	-164.1	2.0	-4.9	NM	NM	0.1	1.0	14.3	3.0	Neutral
Wynn Resorts Ltd	74%	20.8	174%	-49%	2.7	-2%	-13.7%	0.0%	10.6	-85.2	2.0	2.7	-0.5	-12.1	-2.4	0.5	-26.3	3.5	Neutral
Ford Motor Co	659%	-1.4	-5%	-121%	-2.1	-311%	-120.7%	0.0%	6.2	-304.6	3.0	-4.5	NM	NM	NM	0.0	-81.8	4.0	Neutral
Penney (J C) Co	71%	15.4	130%	89%	0.9	-24%	-6.6%	3.6%	-0.3	-42.4	3.0	-4.6	-11.6	-22.7	-3.7	0.0	-25.0	4.0	Neutral
Starbucks Corp	74%	11.7	98%	-50%	2.7	-38%	3.1%	0.0%	1.7	-44.1	3.0	-1.3	0.1	-1.0	-0.3	0.5	-33.3	4.5	NR
Mgm Mirage	406%	11.1	93%	-15%	0.6	-75%	-61.7%	0.0%	-0.4	-6.9	4.0	-1.5	-1.9	-17.7	-1.9	0.0	-39.1	5.0	Neutral
Darden Restaurants Inc	102%	8.0	67%	-10%	2.1	22%	3.9%	3.9%	-1.9	20.4	5.0	-1.1	-6.3	-11.2	-1.9	0.0	40.0	5.0	NR
D R Horton Inc	228%	-10.1	-70%	-280%	0.7	-32%	-99.0%	4.5%	3.1	-37.0	4.0	-24.5	NM	NM	0.6	1.0	-50.0	6.0	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research, Credit Suisse research

However, as we highlight in the section on how to play any rally in credit spreads, we believe we should be discerning and look to buy leverage selectively (see page 16).

Sector allocation:

The essence behind our strategy is to focus on a barbell.

(1) We remain overweight of defensives—a view that we have held since July 2007. Our top defensive overweights are telecoms, US and UK drugs and tobacco.

(2) We add beta by focusing on credit-related plays (insurance, highly leveraged non-cyclical companies) and by focusing on stocks that are exposed to the NJA consumer.

(3) Our only cyclical overweight is technology.

(4) We remain most negative on corporate discretionary spend (short-cycle capital goods, hotels, media, premium airlines).

(5) We prefer consumer cyclicals to corporate discretionary spend and lift our weightings to be only a small underweight in consumer cyclical areas (retailing, autos).

(6) We are underweight resources (and prefer steel to other resource areas) and prefer consumer cyclicals to resources.

(7) We lift banks to be only a small underweight and prefer banks to cyclicals. We prefer underleveraged banks in underleveraged countries (eg, Japanese banks).

We make the following changes to our sector strategy.

(1) We take oil down to underweight so that we are now underweight both energy utilities and oil.

(2) We take regulated utilities down to benchmark from overweight.

(3) We offset this by raising the weighting in some of the credit-related plays (ie, insurance), a small increase in technology weightings and being slightly less underweight consumer cyclicals and banks than before.

Oil: Reduce to small underweight:

We reduce oil to a small underweight on the basis of the following points:

(1) The oil sector has performed much better than should have been expected given the fall in the oil price

Figure 139: **US integrated relative and the oil price**

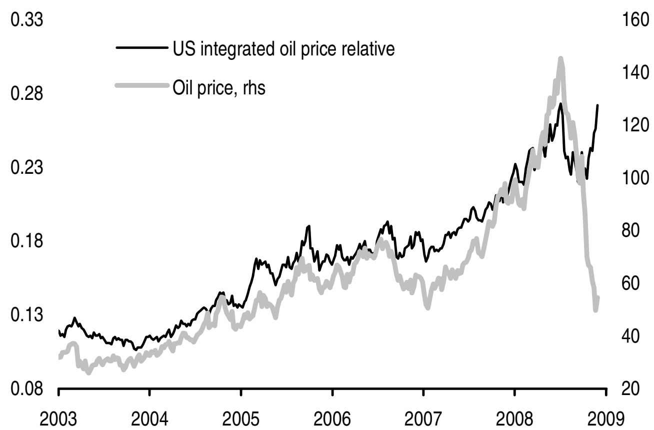

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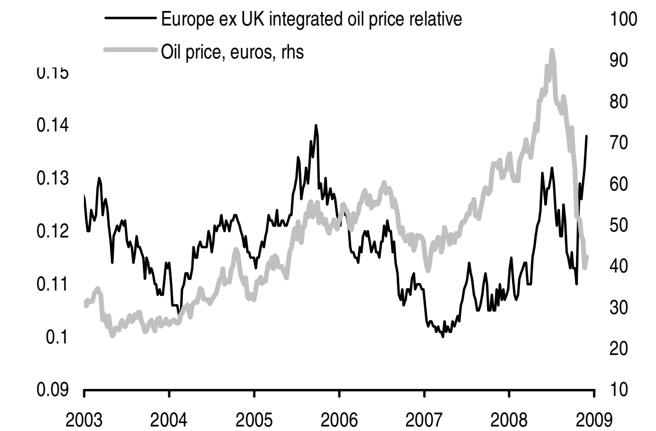
Figure 140: **Europe ex UK integrated relative and the oil price**



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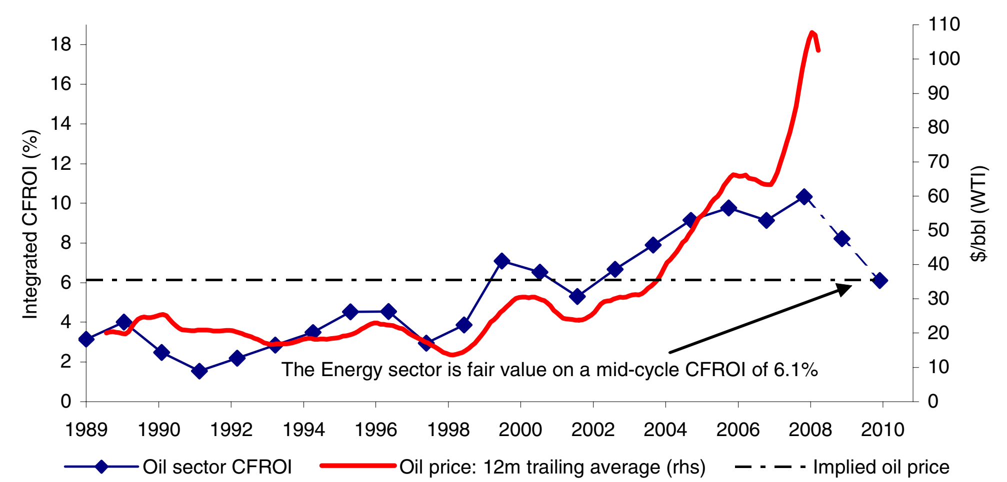
(2) The valuation of the oil sector on both HOLT and conventional measures has now become clearly expensive relative to the market

On HOLT, the oil sector is now discounting an oil price that is close to US$62/bbl on our model (this assumes an F&D charge of US$25/bbl and an upstream tax rate of 56%).

Figure 141: **On HOLT, stocks are pricing in an oil price of around US$60/bbl**



Sector name	CFROI 2008e	CFROI Fades to:	Length of fade	Assumed asset growth	% upside / downside relative to the global market
Global Integrated Oil	10.3	6.1	3	0.5%	0.0%

Source: Credit Suisse HOLT, Credit Suisse research

Figure 142: **Oil sector HOLT model**

Global oil stocks on HOLT		
Oil stocks FY3 CFROI	6.1%	
Oil price model output	$36	
F&D and tax adjustment	$26	
Estimated oil price	$62	
Current oil price	$42	**46%**
WTI 2-year future	$59	**5%**

Source: Credit Suisse HOLT, Credit Suisse research

Figure 143: **Oil model sensitivity analysis**

Oil model: sensitivity analysis				
Scenario	**1990**	**Now**	**Bearish**	**Super bearish**
Oil price model output	$36	$36	$36	$36
F&D costs	$3	$25	$35	$45
Upstream tax rate	49%	56%	65%	70%
Implied oil price	**$39**	**$62**	**$76**	**$90**

Source: Credit Suisse HOLT, Credit Suisse research

Indeed somewhat worryingly the oil sector is implicitly discounting a CFROI® that is well above its long-run average levels (5.1% over the past 20 years).

If we look at the 12-month forward P/E relative of the oil sector, it has bounced back to be above average.

Figure 144: **European oil sector is no longer looking cheap on 12-month forward P/E relatives**

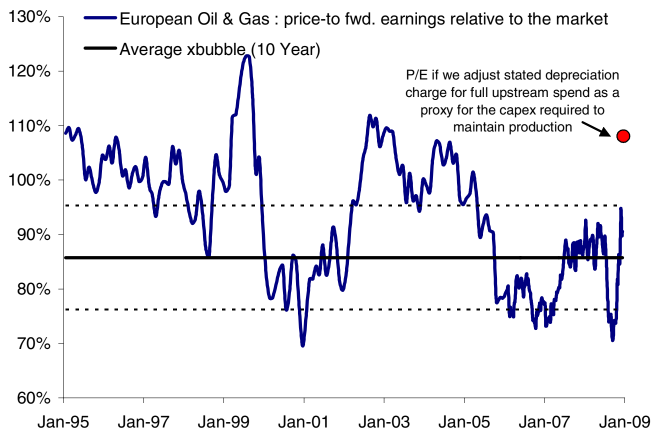


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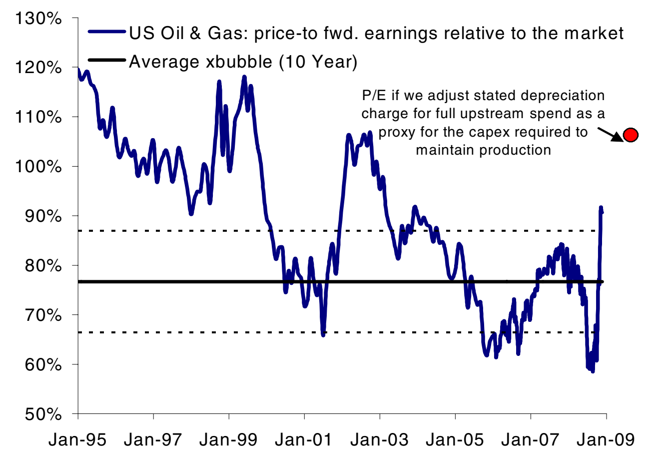
Figure 145: **US oil sector on 12-month forward P/E relatives**



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Integrated Oil Companies' (IOC) earnings are also overstated by the lag in the depreciation charge, which has not risen fully to reflect the fact that the cost of replacing reserves has appreciated in recent years (the capex required to add barrels of reserves to oil company balance sheets should be depreciated on a per barrel basis over the life of the development). Capex has been running at 177% of depreciation since 2000, while FY07 sector reserve replacement (adjusted for production sharing contract, or PSC effects) remains low, at 57%. If we adjust the stated depreciation charge for full upstream spend as a proxy for the capex required to maintain production, the sector P/E would rise by 1.5 points. This would leave P/E relatives even higher. Adjustments to sector reserves estimates to reflect shrinking field lives in a lower oil price environment at year-end could push sector DD&A charges higher as early as for the FY08 results.

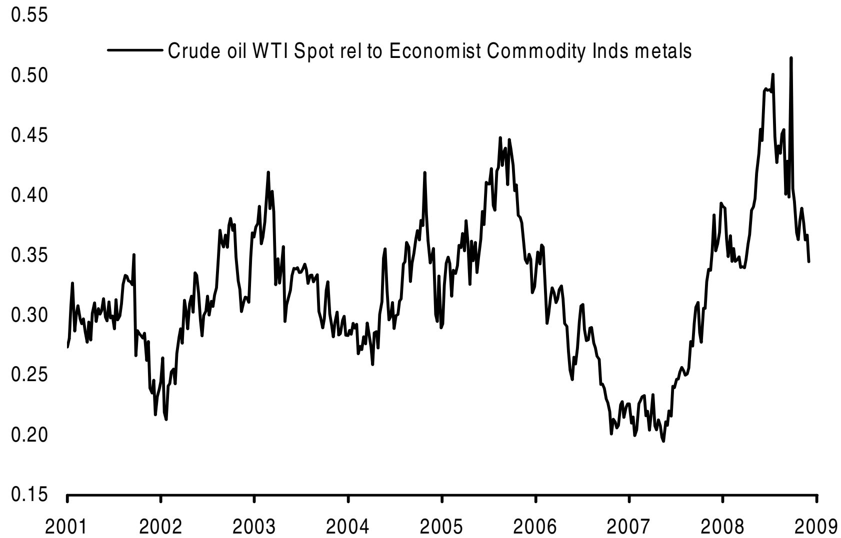
(3) We worry that the oil price might stay around US$40pb–US$50pb for longer than expected. This compares with a two-year forward price of US$62pb

In our view, the problems are the following:

(i) Oil does not look particularly cheap relative to industrial commodity prices

The oil price relative to industrial commodities is still just above its long-term average.

Figure 146: Oil price relative to industrial commodity prices



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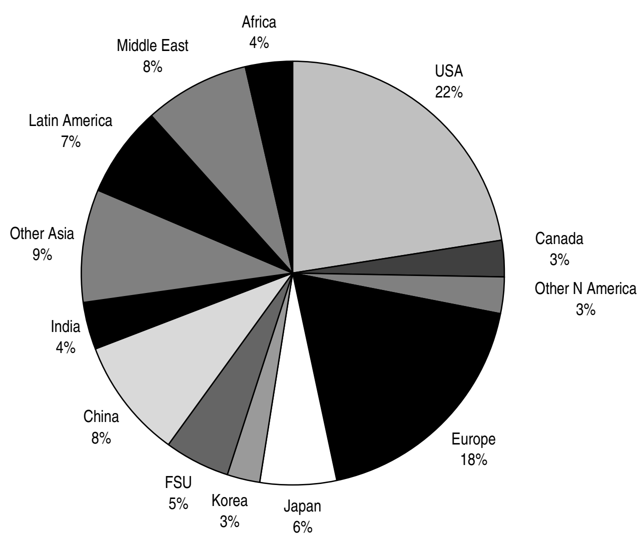
(ii) Half of the oil demand comes from the US, Japan and Europe—economies experiencing a severe recession. Just 8% of global oil demand comes from China.

Figure 147: Share of global oil demand



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The last time the US had a combination of a consumer recession, a high oil price and regulation (favouring greater energy efficiency), US oil demand fell by nearly 22% although a third of this was owing to turning off oil-fired power stations.

Figure 148: Real GDP and oil demand in past US consumer recessions

US consumer recessions	Peak-to-trough fall in: Real GDP	Oil demand
1973-1975	-3.1%	-4%
1979-1982	-2.2%	-22%
1990-1991	-1.3%	-4%

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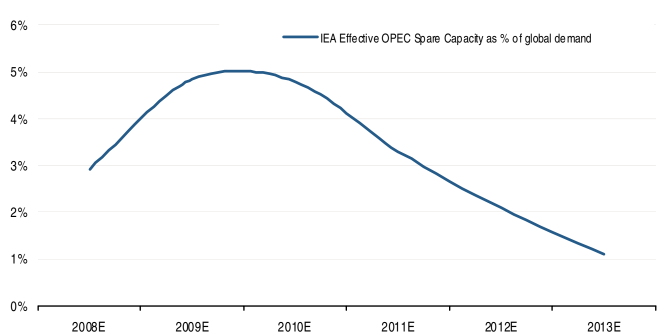
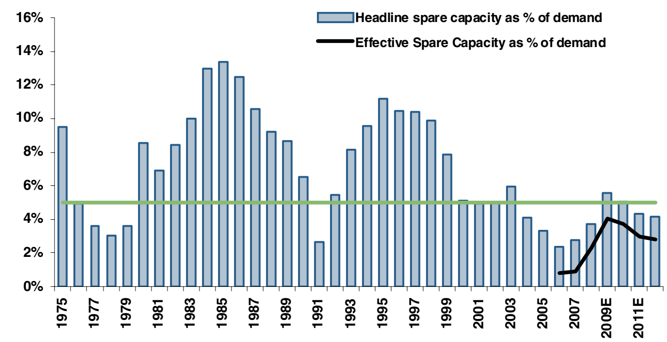
(iii) OPEC tends to lose pricing ability once OPEC spare capacity is above 5%, which the Credit Suisse oil team forecasts it to be in 2009.

Figure 149: IEA Effective OPEC Spare Capacity as % of global demand



Source: Company data, Credit Suisse oil research team estimates

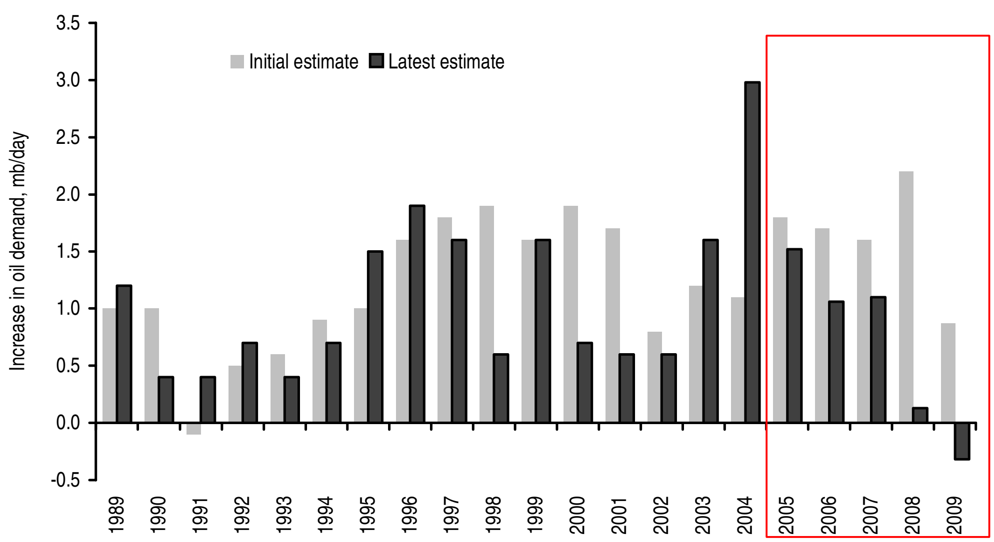
Figure 150: When spare capacity gets above 5% OPEC tends to lose pricing power



Source: Company data, Credit Suisse oil research team estimates

Already OPEC spare capacity is also above 5% for 2009 on IEA projections and just below that level in 2010E.

Figure 151: The final IEA demand estimates have tended to be considerably lower than the initial estimates



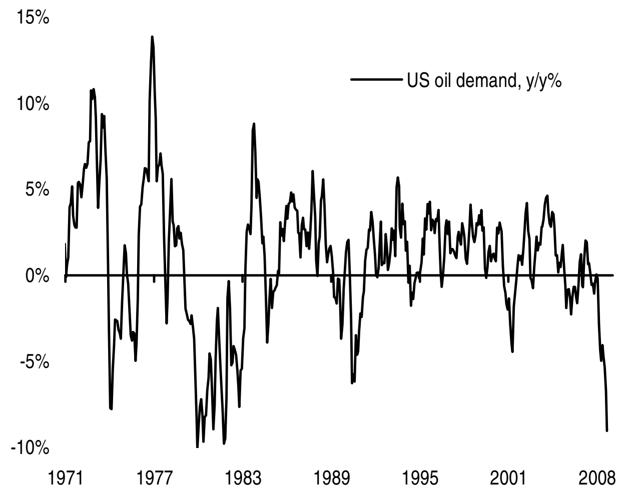
Source: IEA, Credit Suisse research

Already there is pressure on OPEC cohesiveness, with Saudi Arabia required to make the bulk of production cuts and Nigeria, Venezuela, Iran, for example, facing genuine revenue pressures.

If US oil demand fell by 7%, then OPEC spare capacity would rise above 5% for the next five years, on our analysis.

Not only is US oil demand currently down 9% yoy but on our model (Figure 153) US oil demand should be down 7% if US GDP contracts by 3% or more (the model shows the trade off between oil demand to the oil price and GDP growth). The best lead indicators in the US are now consistent with GDP growth of *minus* 2.5% (as shown in Appendix 6).

Figure 152: US oil demand is already falling at a 9% annual rate



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 153: US oil demand growth under different oil price and GDP growth scenarios, assuming energy efficiency improves at half the 1979–85 rate

US GDP growth	Oil price, WTI: 32	40	50	60	72
-3%	-6.9	-7.1	-7.2	-7.4	-7.6
-2%	-5.8	-5.9	-6.0	-6.2	-6.4
-1%	-4.6	-4.7	-4.8	-5.0	-5.2
0%	-3.4	-3.5	-3.7	-3.8	-4.0
1%	-2.2	-2.3	-2.5	-2.6	-2.8
2%	-1.0	-1.1	-1.3	-1.4	-1.6
3%	0.2	0.1	-0.1	-0.3	-0.4
4%	1.4	1.3	1.1	0.9	0.7
5%	2.6	2.4	2.3	2.1	1.9

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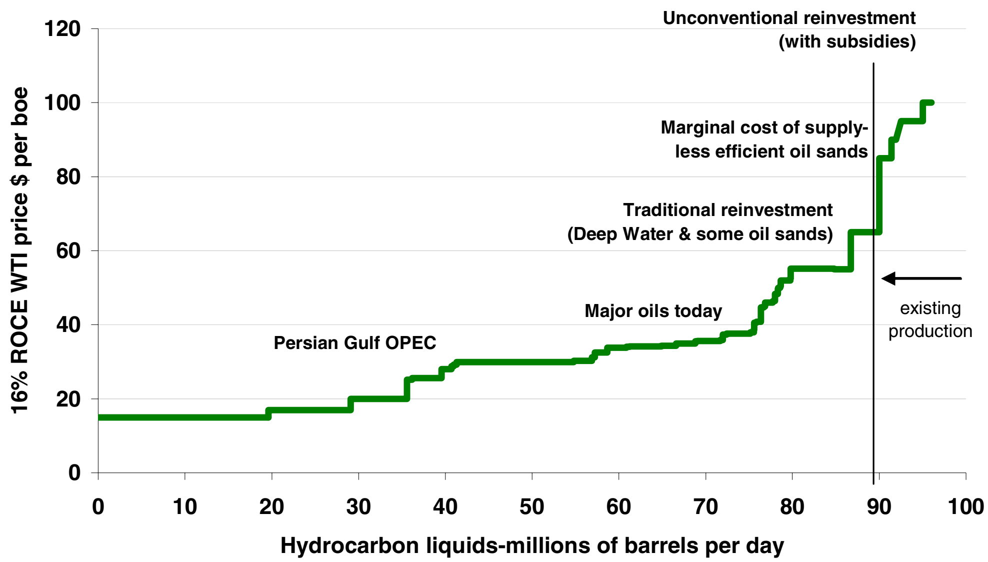
It is interesting to note that the World Bank is now forecasting oil consumption to fall 450k barrels/day next year.

(iv) For industrial commodities, we have seen 60% of copper and 100% of platinum production fall below total breakevens yet for oil around only 5% of production is below break-even levels.

This is in spite of the fact that they have better cartels than OPEC and on some measures have as high depletion rates.

If 40% of oil production were to fall below break-evens, then on our calculations the oil price would fall to around US$30–35pb.

Figure 154: **Oil production versus oil price**



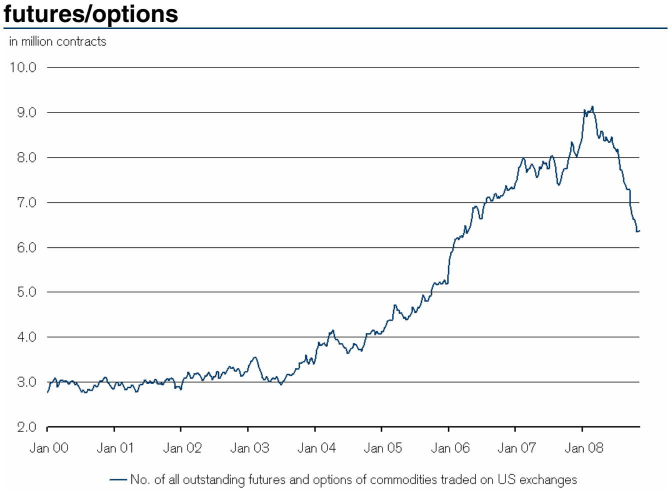
Source: Oil team research, Company data, Credit Suisse research

(v) ETFs

We feel nervous about the potential unwind of commodity ETFs. Why would investors buy commodities in a world where investors are worried about deflation and not inflation.

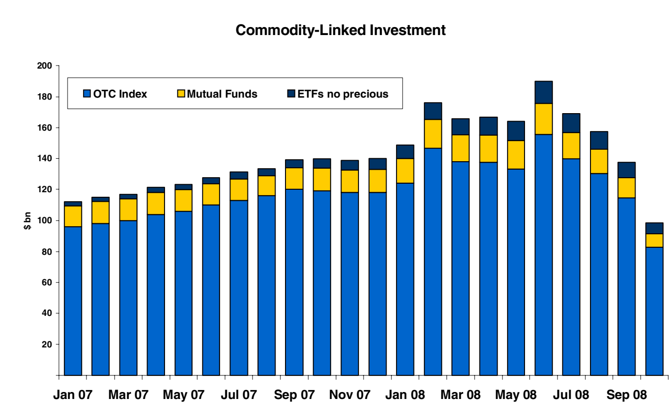
We are worried that as the ETF trades unwind they may create more overshoot in prices. We can see in Figure 155 and Figure 156 that the sharp fall in commodity prices has already led to heavy outflows from commodity-related investor products. The unwind has taken ETFs and open interest in futures back to mid 2006 levels—hardly capitulation.

Figure 155: **Open interest in US commodity futures/options**



Source: CFTC, Credit Suisse Commodities Group research

Figure 156: **Commodity-linked investments**

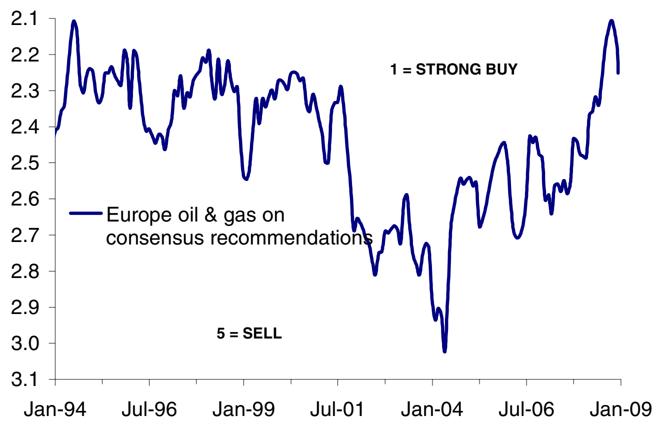


Source: CFTC, Credit Suisse Commodities Group research

(4) Positioning: based on consensus, investors are overweight oil and analysts are particularly optimistic on the energy sector.

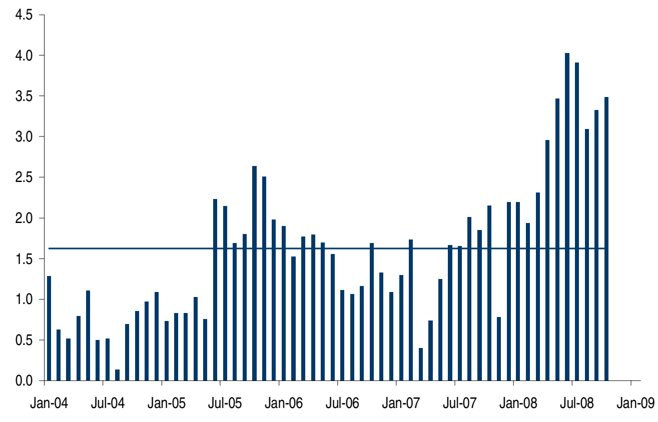
Oil has been a very consensus overweight (the second-largest sector overweight according to the latest Frank Russell survey). European analysts are also very bullish of late.

Figure 157: Oil & gas sector: Analysts are bullish



Source: MSCI, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 158: Frank Russell: Investor weighting in Oil

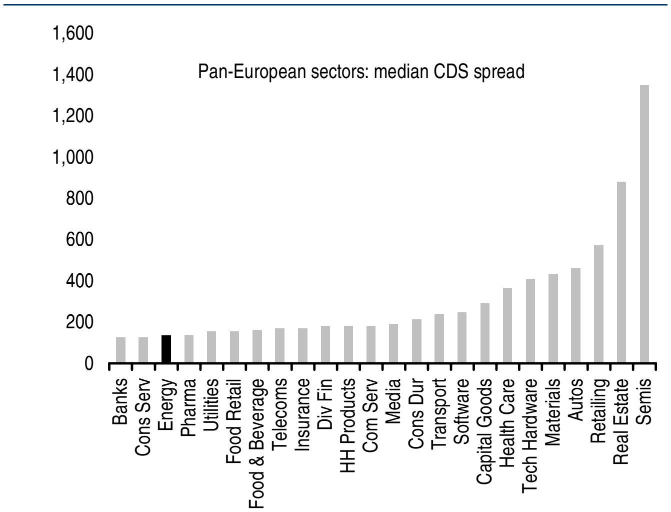


Source: Frank Russell, Credit Suisse research

(5) Are we overpaying for oil's defensiveness?

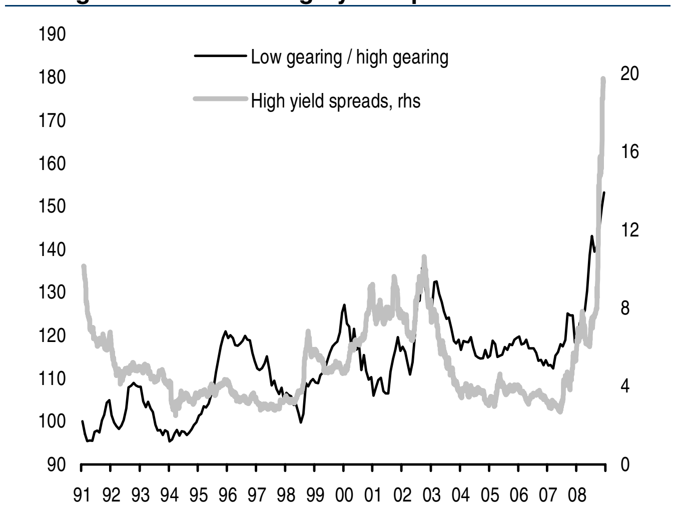
The outperformance of low leveraged companies has followed the rise in credit spreads (see page 66). However, with low leveraged stocks outperforming by 50%, we believe there is a danger that investors overpay for low leverage and oil stocks' leverage and CDS spreads are among the lowest of all sectors. If credit spreads fall in 2009, low leverage may no longer outperform (to be clear we want to avoid very high leverage and low FCF but not necessarily buy the opposite).

Figure 159: Oil CDS spreads are among the lowest for any sector



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse research

Figure 160: Performance of low leverage relative to high leverage stocks versus high-yield spreads



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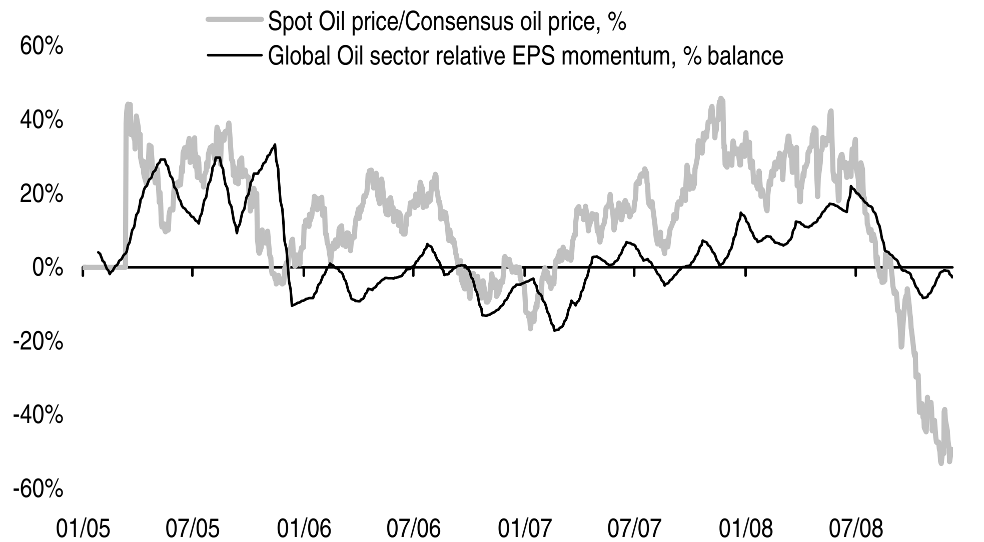
(6) Relative earnings momentum:

We can see that relative earnings momentum has just turned negative, not least because consensus views of the oil price are still as high as US$70pb for 2009 (Figure 161).

Figure 161: Consensus oil price expectations appear to have further to fall, putting further downward pressure on earnings momentum

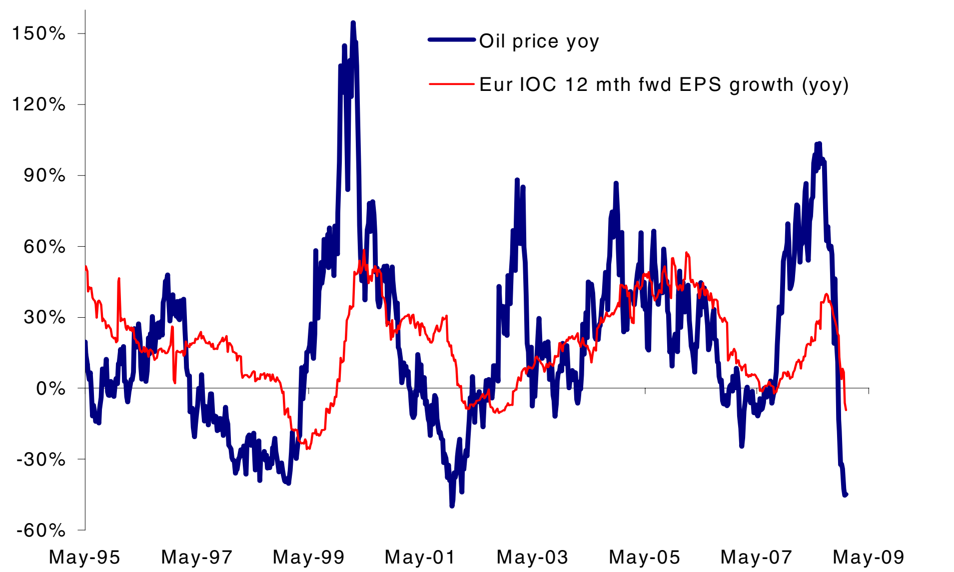


Source: Reuters, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

(7) IOC have been very poor at translating the high oil price into EPS or FCF during the boom

In the past, large oil price increases did not always translate into proportionate FCF or EPS growth for the IOCs. So if IOCs did not manage to turn higher oil prices into strong FCF or EPS in good times (ie, when the oil price was high and rising) what will happen in the bad times?

Figure 162: IOCs' 12-month forward EPS versus oil price (yoy, %)



Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

(8) Sector leadership changes.

We find that leadership nearly always changes from one bull market to the next. If we look at the last three major bull markets, we can see different leadership from the prior bull market.

Figure 163: Sector leadership in the last three bull markets (with ranking in previous bull market in column 2)

Sector	Rank during previous bull mkt (Oct 1990-Mar 2000)	Rel perf: Bull market March 2003-Oct 2007	Sector	Rank during previous bull mkt Aug 1982-July 1990	Rel perf: Bull market Oct 1990-March 2000	Sector	Bull market Aug 1982-July 1990
Met & Min	16	148%	Technology	24	341%	Tobacco	151%
Con & Mat	18	93%	Financial Svs	10	59%	Travel & Leis	116%
Oil & Gas	20	66%	Retail	6	39%	Beverages	85%
Basic Resource	21	64%	Banks	19	16%	Food Products	80%
Travel & Leis	5	62%	**Travel & Leis**	**2**	16%	Food & Bev	79%
Tobacco	25	28%	Inds Gds & Svs	16	0%	Retail	59%
Utilities	24	17%	Media	22	-1%	Cont & Pack	56%
Chemicals	13	16%	Insurance	14	-8%	Health Care	52%
Financial Svs	**2**	12%	Telecom	18	-23%	Pers & H/H Gds	41%
Inds Gds & Svs	6	11%	Health Care	8	-36%	Financial Svs	32%
Real Estate	12	11%	**Beverages**	**3**	-38%	Con & Mat	22%
Telecom	9	7%	Real Estate	12	-44%	Real Estate	20%
Technology	**1**	3%	Chemicals	15	-45%	Met & Min	12%
Cont & Pack	22	-3%	Auto & Parts	17	-49%	Insurance	11%
Pers & H/H Gds	17	-6%	**Food & Bev**	**5**	-53%	Chemicals	7%
Insurance	8	-7%	Met & Min	13	-54%	Inds Gds & Svs	4%
Auto & Parts	14	-13%	Pers & H/H Gds	9	-56%	Auto & Parts	-4%
Retail	**3**	-14%	Con & Mat	11	-59%	Telecom	-8%
Beverages	11	-21%	Forestry & Pap	23	-61%	Banks	-11%
Food Products	23	-21%	Oil & Gas	20	-62%	Oil & Gas	-15%
Food & Bev	15	-21%	Basic Resource	21	-63%	Basic Resource	-17%
Forestry & Pap	19	-22%	Cont & Pack	7	-65%	Media	-23%
Banks	4	-22%	**Food Products**	**4**	-66%	Forestry & Pap	-25%
Health Care	10	-22%	Utilities	25	-71%	Technology	-26%
Media	7	-23%	**Tobacco**	**1**	-80%	Utilities	-42%

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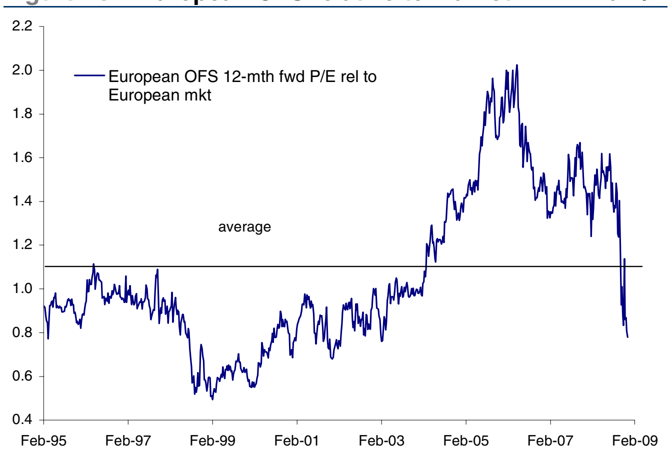
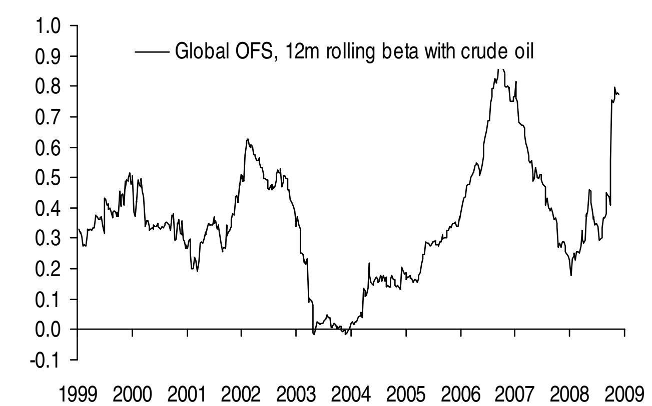
We are particularly concerned about *oil-field services (OFS).* We can not understand why any oil company would spend money on OFS when not only may it be more prudent to pay back debt, but it is also cheaper to buy assets in the stock market rather than drill in the ground. We can see the beta of OFS companies relative to the oil price has risen considerably over the past year, which is another way of saying that they have become very high risk plays.

Figure 164: European OFS relative to market: 12m fwd P/E



Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 165: OFS rolling beta with the oil price



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Overall, the aggregate cash flow of the IOCs after dividends does not leave much room for incremental capital spending.

Figure 166: IOC companies' cash flow, dividends and cash flow (after dividends) available for capital spending

US$ in billions, unless otherwise stated

	2007 (assuming WTI oil price of US$72)	2008E (assuming WTI oil price of US$101)	2009E (assuming WTI oil price of US$60)
Cash flow	194.3	214.3	185.1
Dividends	25.1	27.0	28.7
Cash flow (after dividends) available for capital spending	**169.2**	**187.4**	**156.3**

Source: Company data, Credit Suisse oil team research estimates

What is the risk?

The risk is that depletion rates are high. According to the IEA, if there is no significant investment depletion rates are likely to be around 10% pa.

As we show earlier in Figure 151, in 2005–2007 oil demand disappointed every year but until this year the oil price did not fall. The reason is depletion.

We would avoid the expensive OFS stocks.

Figure 167: OFS stocks that look expensive on our aggregate scorecard

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------								
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Exterran Holdings	7.4	128%	n/a	0.4	n/a	-0.1%	n/a	-0.2	29.1	4.0	-0.8	-5.8	-7.4	-1.0	0.0	42.9	4.0	Neutral
Dresser-Rand	6.7	116%	n/a	1.8	n/a	14.1%	0.0%	-1.2	97.6	4.0	9.9	-0.4	-2.1	-0.1	0.5	50.0	4.5	NR
Global Industries	6.5	114%	n/a	0.4	n/a	-48.1%	n/a	-2.5	86.5	4.0	-16.1	NM	NM	-13.2	0.0	-33.3	5.0	Neutral
Grey Wolf Inc	12.3	214%	n/a	1.4	n/a	-2.6%	n/a	-5.6	18.5	4.0	-4.5	-1.1	-5.4	-0.8	0.0	-80.0	5.0	NR
Hercules Offshore Inc	4.2	74%	n/a	0.2	n/a	1.3%	0.0%	-11.0	156.9	4.0	-11.1	-6.6	-30.4	-3.5	0.0	-5.3	5.0	Neutral
Sbm Offshore Nv	7.1	123%	-22%	1.4	-37%	-7.7%	6.8%	0.0	-20.6	4.0	-3.7	-2.2	4.1	2.8	1.0	13.0	5.0	Neutral
Unit Corp	5.5	96%	n/a	0.7	n/a	-2.6%	n/a	-14.9	153.7	5.0	-2.9	-4.5	-10.7	-4.9	0.0	0.0	5.0	NR
Parker Drilling Co	4.6	79%	n/a	0.6	n/a	-23.4%	n/a	-3.8	214.6	5.0	-0.6	-2.9	-11.0	NM	0.0	0.0	5.0	NR
Oceaneering	6.1	106%	n/a	1.3	n/a	5.4%	n/a	-3.3	70.0	5.0	0.2	-0.2	-0.2	-1.0	0.5	83.3	5.5	Neutral
Pioneer Drilling Co	4.9	85%	n/a	0.5	n/a	-22.7%	0.0%	-9.4	245.4	4.0	2.5	5.4	5.8	1.7	2.0	11.1	6.0	NR
Seacor Holdings Inc	7.5	130%	-18%	0.8	9%	-21.1%	n/a	-0.9	28.3	4.0	0.4	NM	NM	NM	2.0	n/a	6.0	NR
Cameron International Corp	7.1	124%	-42%	1.9	6%	9.7%	n/a	-3.2	59.6	5.0	2.2	0.0	-0.5	0.1	1.0	47.4	6.0	Neutral
Superior Energy Services	3.5	62%	n/a	1.0	n/a	4.5%	n/a	-11.6	213.4	5.0	3.3	-0.4	-2.3	1.3	1.0	100.0	6.0	NR
Petroleum Geo Svs	1.8	31%	-75%	0.7	-84%	35.2%	0.0%	-8.1	261.9	6.0	-0.9	-4.3	-11.0	-3.2	0.0	10.0	6.0	Neutral
Oil States Intl Inc	4.2	73%	n/a	0.7	n/a	4.1%	n/a	-13.3	184.5	5.0	1.1	-0.2	11.7	9.0	1.5	11.1	6.5	Neutral
Bj Services Co	6.3	110%	-36%	1.0	-57%	-1.4%	1.9%	-10.3	67.3	5.0	-5.1	0.0	-0.1	0.5	0.5	-14.3	6.5	Underperform
Diamond Offshre Drilling	5.6	98%	-57%	2.7	-11%	9.8%	9.7%	0.7	47.6	6.0	6.4	-0.2	-2.7	-0.4	0.5	31.3	6.5	Neutral
Schlumberger Ltd	9.0	157%	-33%	2.8	-6%	7.8%	1.9%	-1.6	15.7	6.0	0.8	-1.1	-3.4	-0.3	0.5	66.7	6.5	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

We are also apprehensive about the expensive IOCs. Credit Suisse analysts would express relative caution on: Statoil, Sinopec, and Rosneft. The IOCs most vulnerable in our view are those committed to high-cost new projects with high reserves replacement ratios and high refining exposure.

Credit Suisse analysts' top picks in IOC are: BG and Marathon.

Figure 168: Integrated oil and gas companies that look expensive on our aggregate scorecard

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Sandridge Energy Inc	32.2	365%	n/a	0.4	n/a	-116.2%	0.0%	2.4	-185.6	0.0	2.7	-4.0	-18.8	-0.5	0.5	9.1	0.5	Neutral
Exxon Mobil Corp	11.8	134%	27%	3.2	79%	10.1%	2.0%	2.1	-17.2	1.0	1.5	-2.2	-7.0	NM	0.7	33.3	1.7	Neutral
Chevron Corp	9.7	110%	16%	1.8	27%	8.4%	3.5%	-0.3	-8.5	2.0	2.0	-2.2	-9.0	NM	0.7	20.0	2.7	Neutral
Hess Corp	9.0	103%	-19%	1.2	24%	3.6%	0.9%	-2.6	22.4	3.0	1.4	-3.3	-18.6	NM	0.7	7.7	3.7	Neutral
Vostok Gas Limited	-15.5	-176%	n/a	0.1	n/a	-760.3%	0.0%	-35.8	956.6	4.0	-88.9	NM	NM	NM	0.0	n/a	4.0	NR
Western Gas Partners	8.9	100%	n/a	0.5	n/a	n/a	8.5%	n/a	n/a	4.0	n/a	-4.6	-13.1	1.8	0.7	55.6	4.7	Restricted
Eni	7.2	82%	7%	1.7	21%	11.9%	8.0%	-2.6	23.9	5.0	-0.7	0.0	-2.6	-1.6	0.0	61.1	5.0	Underperform
Statoilhydro Asa	7.2	82%	13%	1.9	15%	8.6%	7.5%	-1.7	11.7	5.0	-0.8	-7.0	-17.0	-3.0	0.0	41.2	5.0	Underperform
Murphy Oil Corp	9.0	102%	-18%	1.2	-7%	0.3%	2.1%	-3.7	23.9	4.0	5.6	-3.1	-13.2	NM	0.7	-84.6	5.7	Underperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Regulated utilities: Take to benchmark from overweight

This is simply to reflect two major anomalies in our view.

(1) First, we have always believed that regulated utilities were an index-linked bond proxy

In other words, when real bond yields were low, then regulated utilities (which de facto gave a much higher fixed real rate of return) offered an attractive investment. However, we have seen a huge outperformance of regulated utilities at the same time as a sharp rise in indexed linked bond yields. This is especially the case in the UK (Figure 170).

Figure 169: **UK RPI and utilities relative performance . . . utilities underperform when inflation falls**

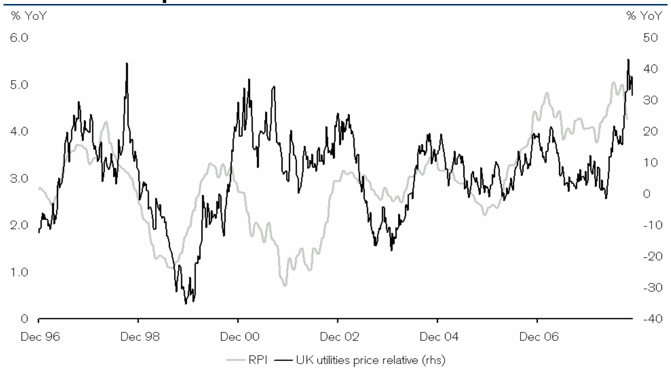

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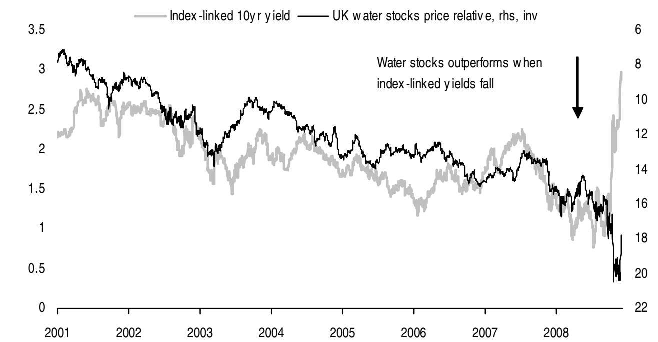
Figure 170: **UK index-linked bond yields and UK water utilities rel performance (inverted)**



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In addition, regulated utilities typically underperform when there is a sharp fall in inflation (Figure 169) as we expect there to be.

Moreover, the sector has become extremely expensive vis-a-vis the market on P/E, dividend yield and HOLT (Figure 171 to Figure 175).

Figure 171: **European regulated utilities' 12-mth fwd P/E relative to market excluding financials**

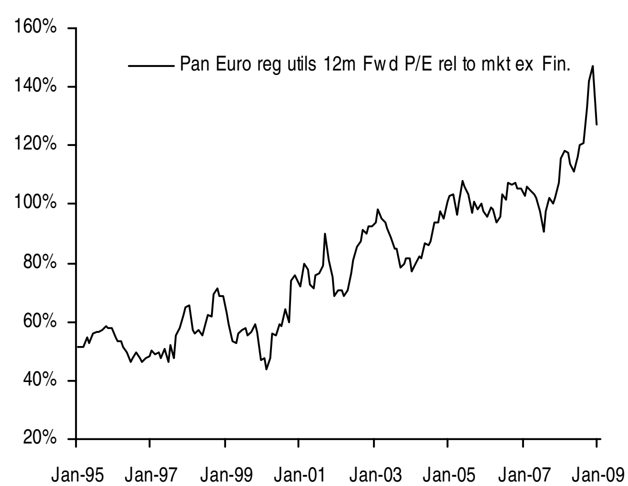

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Figure 172: **European regulated utilities' P/B relative to market excluding financials**

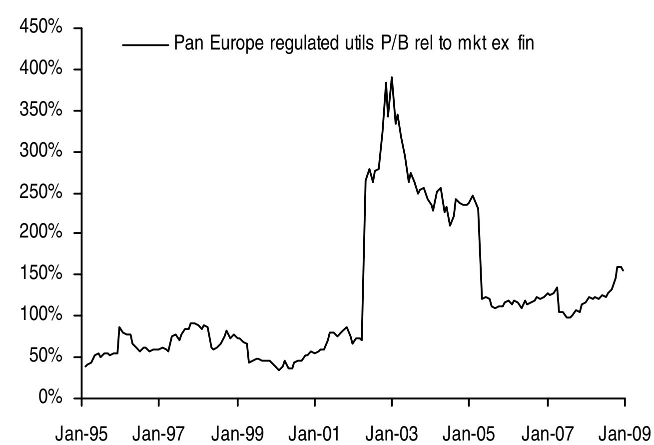

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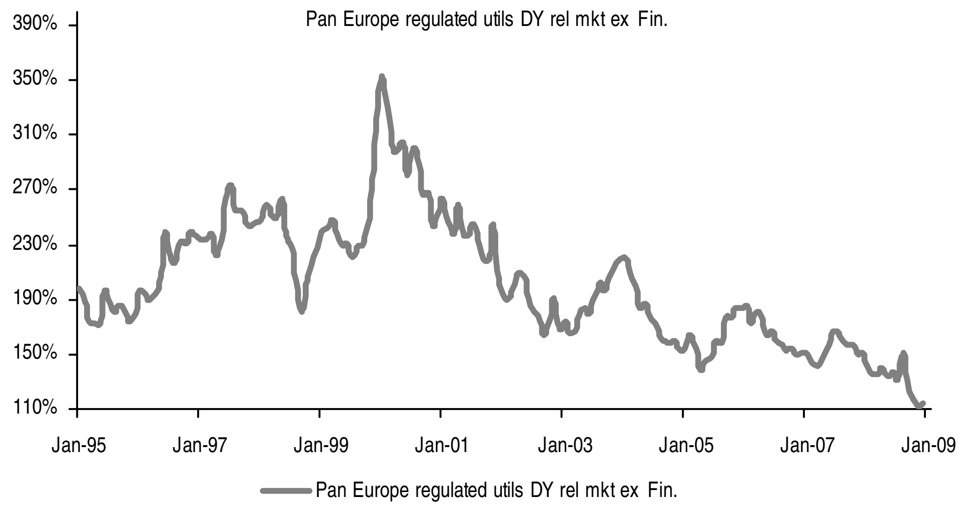
Figure 173: **European regulated utilities' DY relative to the market excluding financials**



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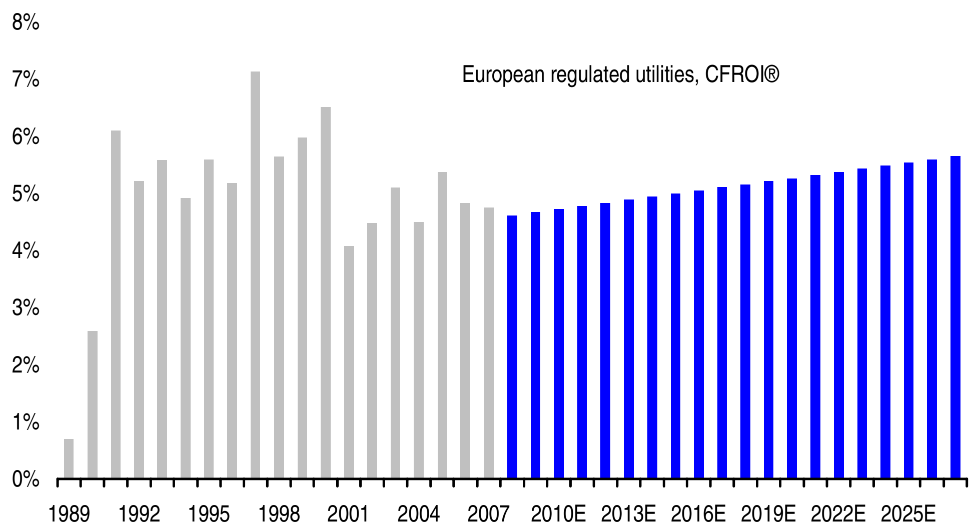
On HOLT, European regulated utilities discount require a 20-year CFROI® of 5.6% (assuming real asset growth of 2% and a real cost of capital of 6%) to be fair value relative to the European market. This is above the 2008E CFROI® (4.6%) and the long-term average CFROI® (5.3%).

Figure 174: **European regulated utilities require a 20-year CFROI® above both present levels and the long-term average**



Source: Credit Suisse HOLT, Credit Suisse research

Figure 175: **European regulated utilities on HOLT: Model inputs and outputs**

Sector name	CFROI		Implied CFROI fade (percentage points)	Model inputs			Historical average (15 years)	
	2008E	Required FY5		Length of fade (y)	Assumed RAGR	Real cost of capital	CFROI	RAGR
European regulated utilities	4.6%	5.6%	1.0%	20	2.0%	6.0%	5.3%	6.7%

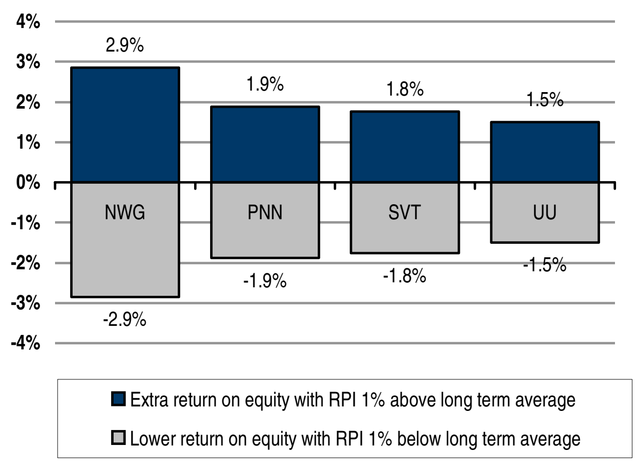
Source: Credit Suisse HOLT, Credit Suisse research

(2) There are two very substantial risks.

(i) First, regulated utilities are more inflation than deflation hedges. In a period of deflation, the risk is RPI-based formulae go negative.

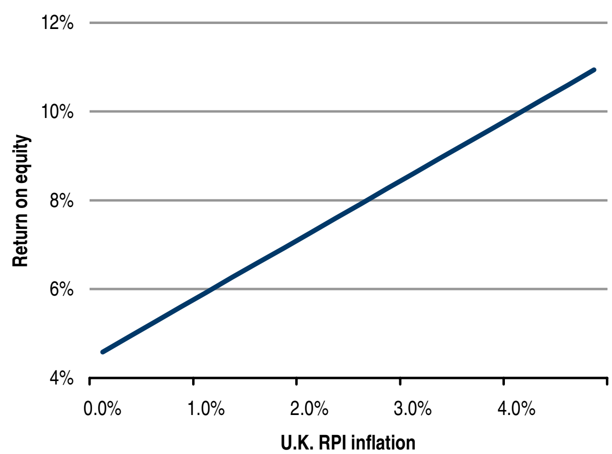
Credit Suisse's UK water stocks analyst, Mark Freshney, highlights that regulatory asset bases (RABs) and allowed revenues are usually linked to inflation (as in the UK water/power sectors, and to an extent in Italy for Snam and Terna), yet most of these assets are funded through fixed-rate debt. Hence the equity is levered in higher-or-lower than expected inflation (see Figure 176 and Figure 177). Each 1% pt lower RPI for one year takes 1.5% pts to 3% pts off RoEs.

Figure 176: **Leverage of equity valuations to RPI (1% higher / lower for one year only)**



Source: European utilities team, Credit Suisse estimates

Figure 177: **UK Water: Leverage to RPI inflation over one year**



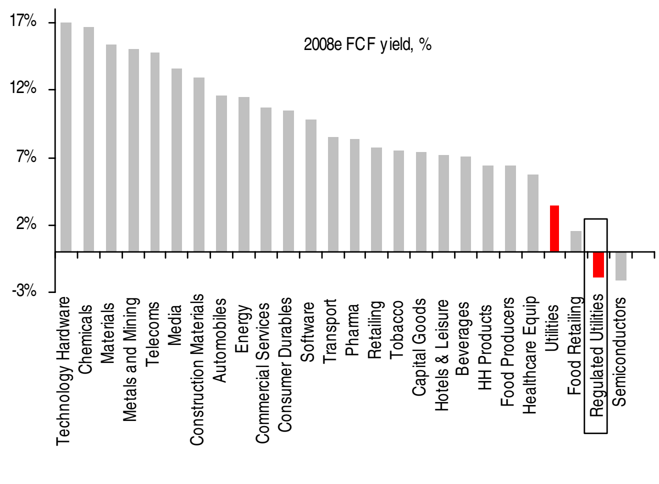
Source: European utilities team, Credit Suisse estimates

An additional worry is that UK water's incremental capex is mainly funded through debt. If the cost of borrowing remains high and the regulators do not allow increased price limits, we could see value-destruction for new expenditure.

(ii) Secondly, bad debts of the customer-facing business could rise.

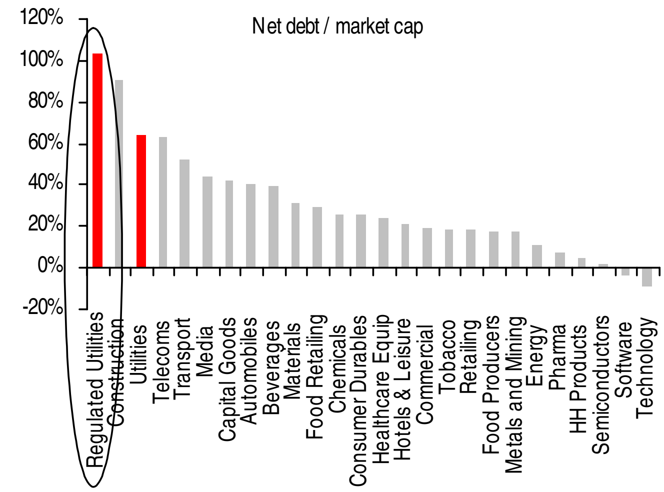
(iii) Third, this is a sector with relatively poor FCF and, above all, high leverage—a combination that we do not like!

Figure 178: **European regulated utilities' 2008E FCF yield relative to the market—very poor**



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse estimates

Figure 179: **European Regulated utilities' net debt as % of market cap (latest reported)—the highest of all sectors**



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(iv) There is significant risk of a windfall tax. The UK budget deficit could, in our opinion, reach 12% of GDP—and corporates do not vote! There was, after all, a £5bn windfall tax on water companies in 1997. Although this would be counterproductive (as it would basically hobble an essential service), the possibility of this happening cannot be dismissed although the risk is higher for energy utilities than for regulated ones).

On consensus, both analysts' positioning and price momentum is middling.

Figure 180: **Analyst consensus recommendations**

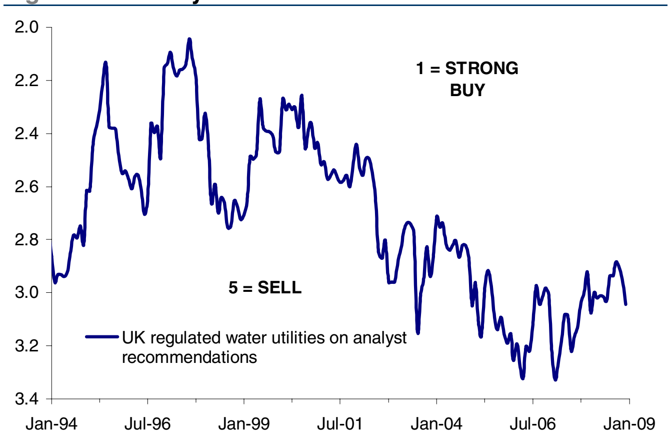

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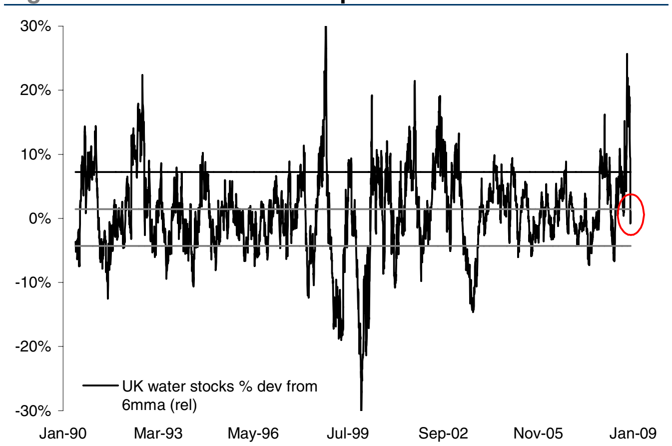
Figure 181: **UK water stocks' price momentum**



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

We note that the relative earnings momentum of the regulated utilities in Europe is close to the top of its range—does it get any better?

Figure 182: European regulated utilities' earnings momentum—close to the top of its range

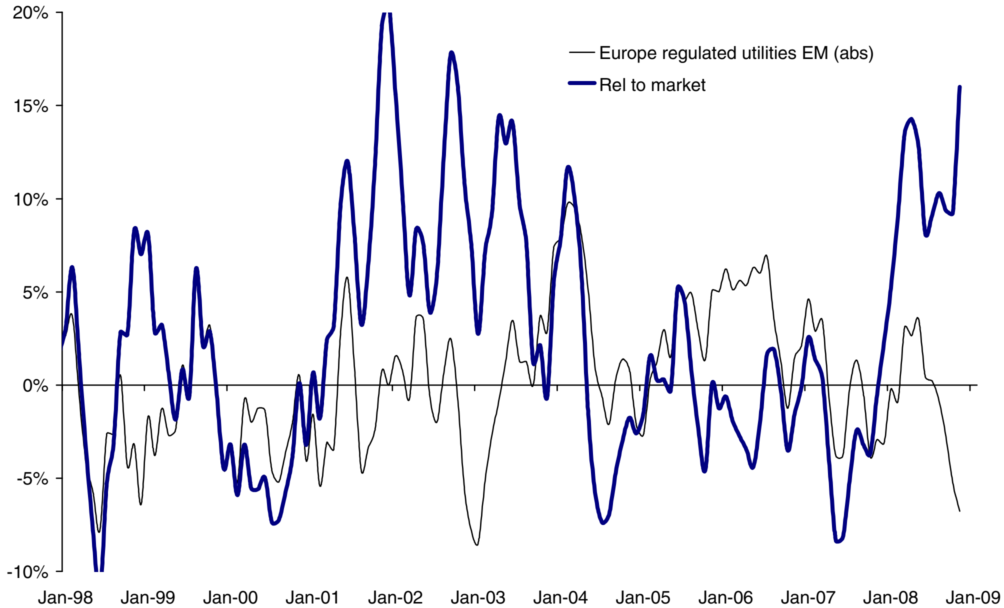


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Figure 183 shows the European regulated utilities that look expensive on HOLT and have a low 2008E FCF yield. Credit Suisse's European utilities team would avoid Severn Trent and Enagas.

Figure 183: European regulated utilities that look expensive on HOLT and have a low FCF yield

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Snam Rete Gas	14.4	110%	51%	2.2	144%	2.9%	5.5%	5.4	-67.3	1.0	-0.4	-0.9	-3.3	-0.7	0.0	-18.2	2.0	Neutral
Red Electrica Corp	14.5	122%	n/a	3.9	n/a	-0.4%	3.5%	5.2	-51.9	0.0	0.6	-0.9	-0.7	-0.1	0.5	41.7	0.5	Outperform
Enagas Sa	11.4	87%	14%	2.4	45%	-3.2%	4.6%	4.7	-50.8	2.0	-0.3	1.8	2.4	0.2	1.5	66.7	3.5	Underperform
Pennon Group	12.3	90%	97%	2.4	285%	1.8%	4.8%	4.3	-63.0	1.0	0.2	-1.8	-6.9	0.2	1.0	-28.6	3.0	Outperform
National Grid	11.5	115%	47%	3.1	18%	-5.5%	5.5%	1.9	-38.9	1.0	-0.4	-1.2	-2.7	0.3	0.5	-29.4	2.5	Underperform
United Utilities G	10.5	104%	n/a	1.2	n/a	-0.2%	5.6%	1.2	-37.0	1.0	-1.0	-0.6	-6.7	2.2	0.5	-75.0	2.5	Neutral
Northumbrian Wtr G	10.0	73%	n/a	2.6	n/a	-1.5%	5.2%	3.4	-71.0	3.0	0.3	-0.6	-1.5	0.7	1.0	-50.0	5.0	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

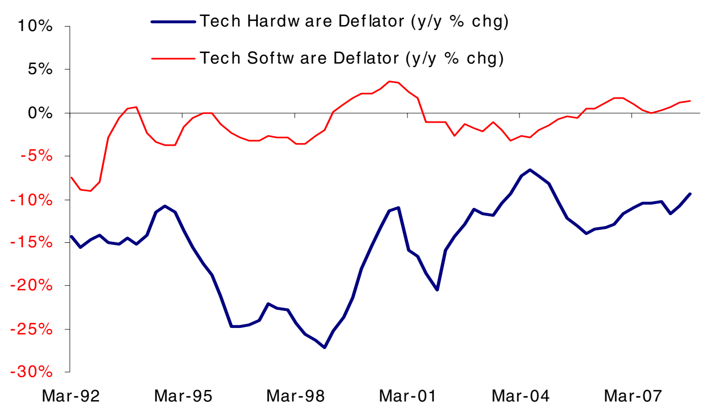
Technology: Adding money (a small overweight)

We believe that it is right to be a small overweight of technology. It is the only cyclical sector we are overweight.

We do this for the following reasons:

(1) The sector has been used to deflation for many years
Deflation in the tech sector has been persistent. Tech hardware has lived through constant deflationary pressures over the past decades while software has gone through many bouts of deflation. Given the industry experience with pricing, we think the sector will be better able to cope with the dis-inflationary environment, which we are likely to see going forward.

Figure 184: **Tech hardware and tech software deflators**



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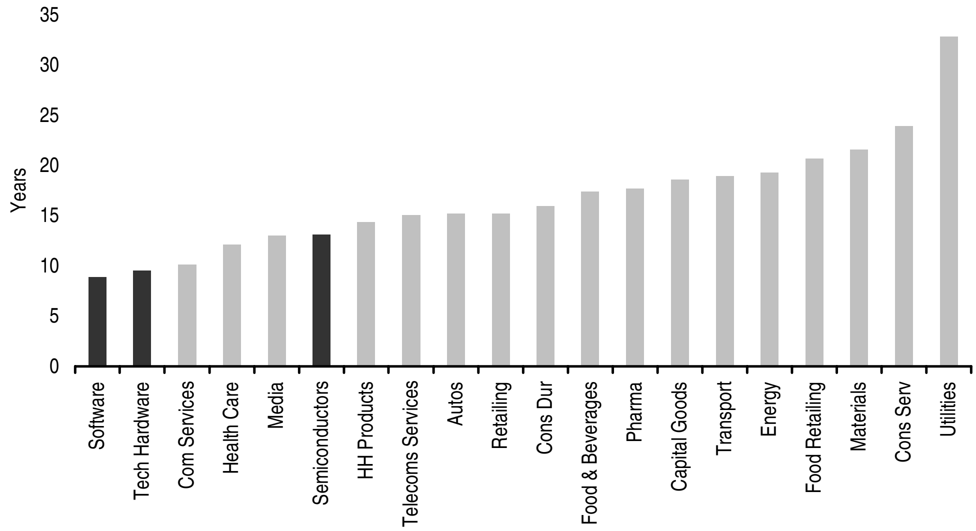
(2) This is also a sector that has a very short asset life
Software, semis and tech hardware companies have short asset lives. This means the sector can quickly 'right-size'. We show in our theme section that short asset-life companies outperformed in Japan during their period of deflation (see page 58).

Figure 185: **Pan-European sectors: Asset life**

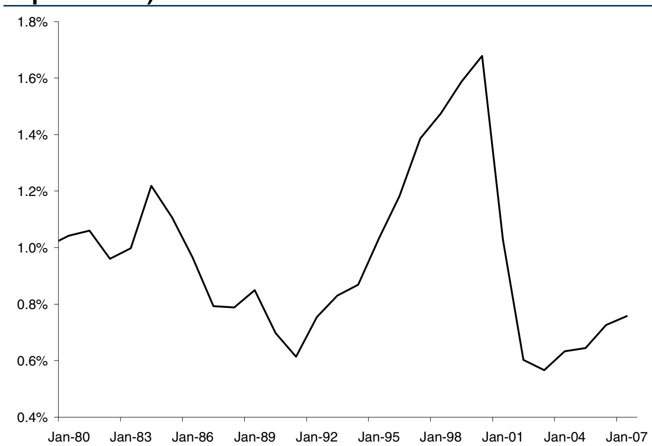


Source: Credit Suisse HOLT

(3) Overall there is under-investment in technology—the technology share of GDP is low, especially if we net out depreciation

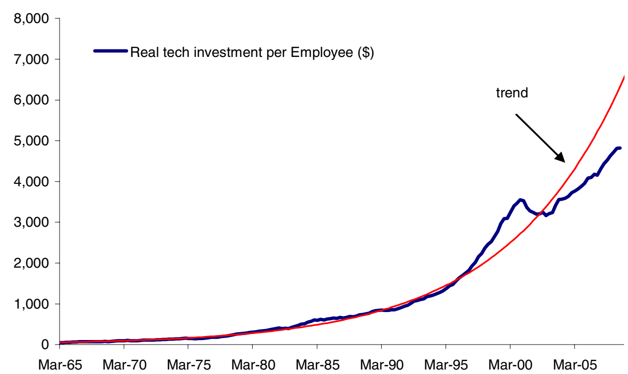
While gross investment as a proportion of GDP is well above the mid-1990s level, investment in technology net of depreciation is 0.75% of GDP—20% below its average. Real tech investment per employee is 20% below trend.

Figure 186: **Net tech investment as % of GDP (net of depreciation)**



Source: BEA, Credit Suisse research

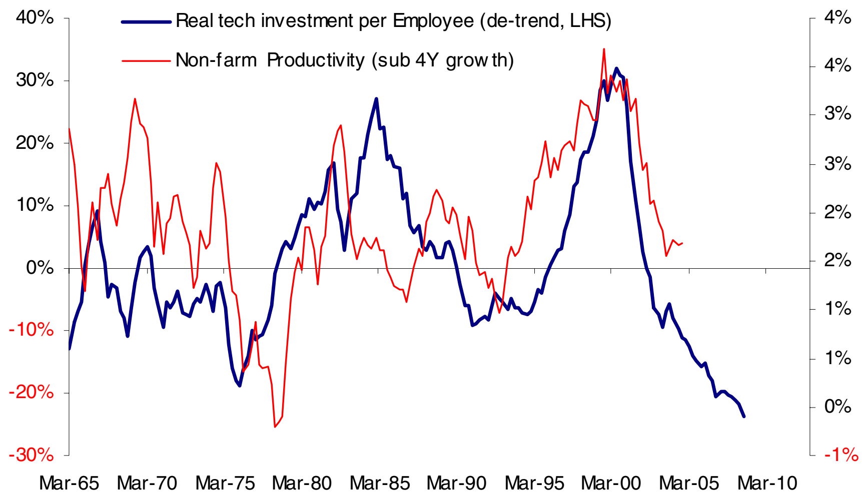
Figure 187: **Tech investment per employee is 20% below trend**



Source: BEA, Credit Suisse research

Tech investment is critical to improving labour productivity in the long run. Tech investment per employee leads productivity growth by a couple of years. Current trends in tech intensity show a marked deceleration. We believe that into deflation, corporates will seek to improve productivity and investing in technology is a good way to achieve this. (We doubt that real wage growth will fall that much.)

Figure 188: **Investment in technology and productivity growth go hand in hand**

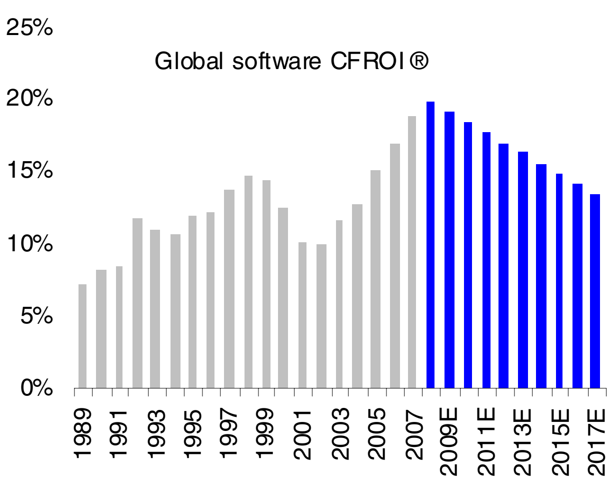


Source: BEA, Credit Suisse research

(4) Tech companies have relatively attractive valuation

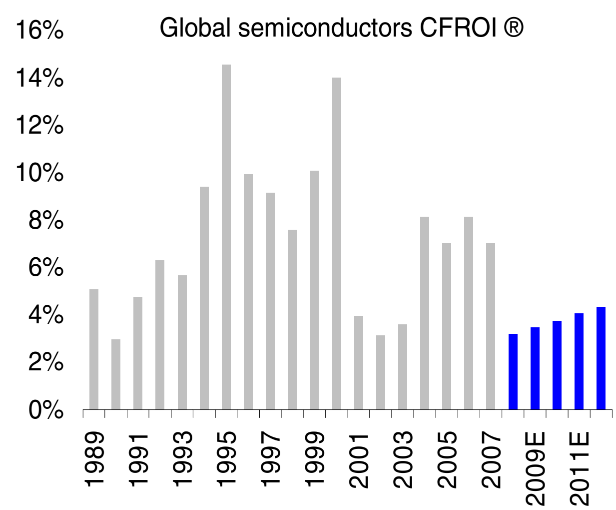
The most attractive sub-sectors on HOLT from a global point of view are software and semis—where the levels of profitability required to make the sectors fair value relative to the market are low.

Figure 189: **Global software on HOLT**



Source: Credit Suisse HOLT

Figure 190: **Global semiconductors on HOLT**



Source: Credit Suisse HOLT

We show the charts for global IT and tech hardware in Appendix 7.

Figure 191: **Global tech on HOLT: Model inputs and outputs**

Sector name	CFROI® 2008E	CFROI® Required	Implied CFROI® fade	Model inputs: Length of fade (y)	Model inputs: Assumed RAGR	Model inputs: Real cost of capital	Historical average (10 years): CFROI®	Historical average (10 years): RAGR
Global IT	9.3%	9.3%	0.0%	5	5.0%	6.0%	7.4%	6.3%
Global semiconductors	3.2%	4.3%	1.1%	5	6.0%	6.0%	7.3%	10.0%
Global software	19.9%	13.4%	-6.5%	10	7.0%	6.0%	13.8%	12.1%
Global tech hardware	8.2%	7.2%	-1.0%	5	4.0%	6.0%	5.8%	4.2%

Source: Credit Suisse HOLT

On conventional relative price to sales, tech is trading at its long-run average and tech hardware is trading on a P/B relative below its long-run average.

Figure 192: **Global tech hardware P/B relative to market**

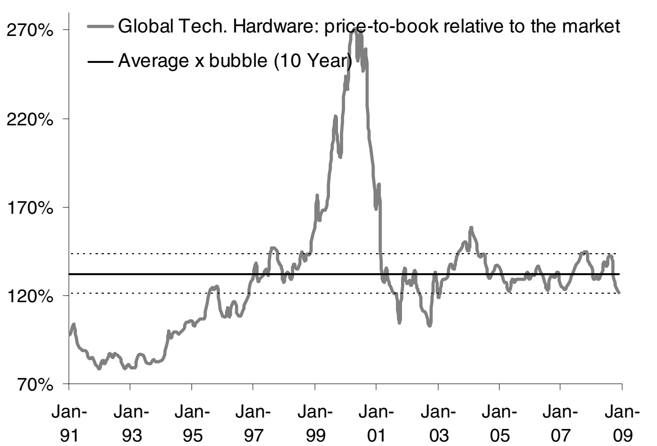


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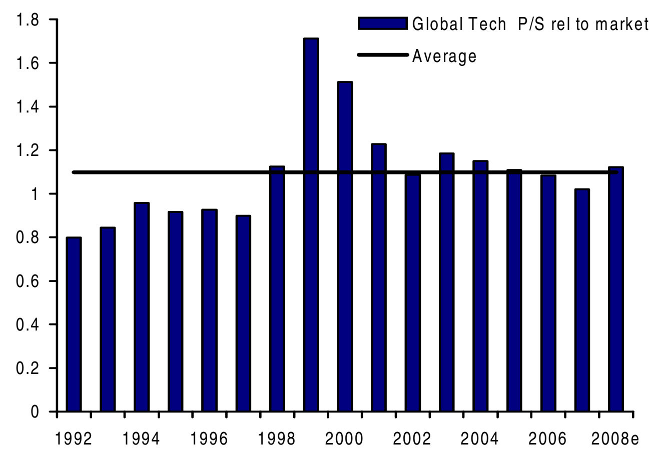
Figure 193: **Global tech P/Sales relative to market**



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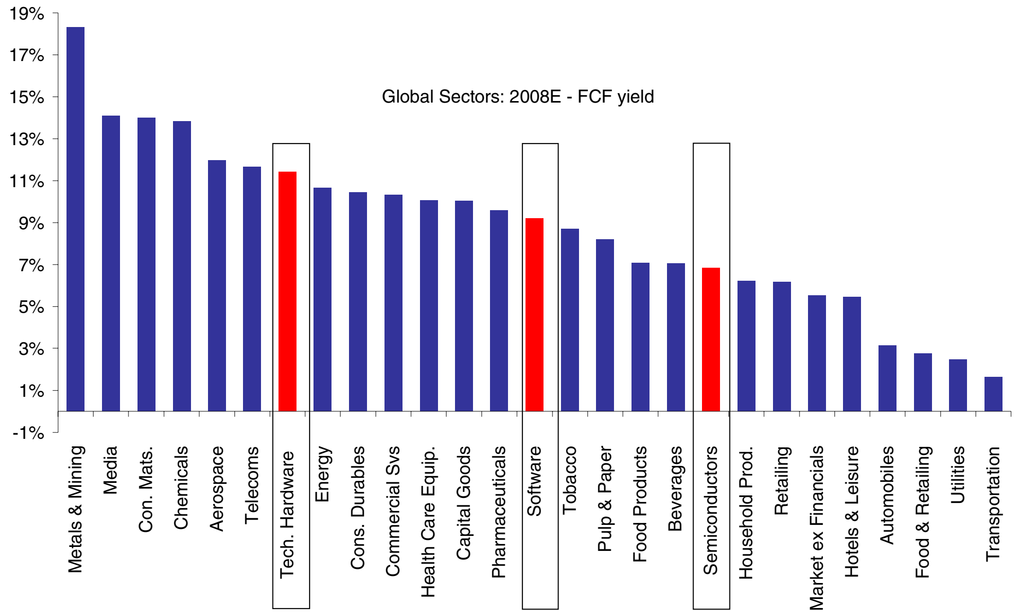
The 2008E FCF yields of the tech sectors look attractive at 11%, 9% and 7% for hardware, software and semis, respectively, compared with 5% for the market.

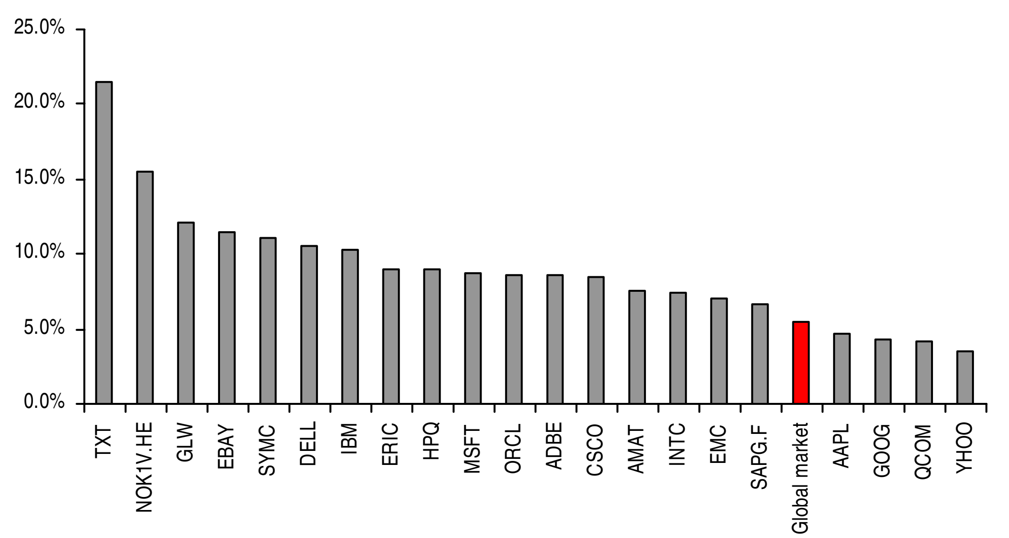
Figure 194: Global sectors' FCF yield, %



Source: © Datastream International Limited ALL RIGHTS RESERVED, I/B/E/S, Credit Suisse research

Figure 195 shows the FCF of the big tech companies in the US. Again they are generally on the high side.

Figure 195: 2008E FCF yield of large-cap US tech companies and big cap European tech



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(5) We think that tech, during this cycle, is better positioned than has previously been the case, as:

(a) more of the commodity-related production is outsourced to Asia and thus the control of inventory is better.

Despite collapsing demand, inventory in the tech companies has not risen to 2000–01 levels. This suggests better inventory management. Tech's inventory to shipments (IS) ratio relative to its trend is at the high end of its historical range, but compared with other sectors looks fairly reasonable.

Figure 196: Tech IS (inventory to shipments ratio) relative to trend is coming down

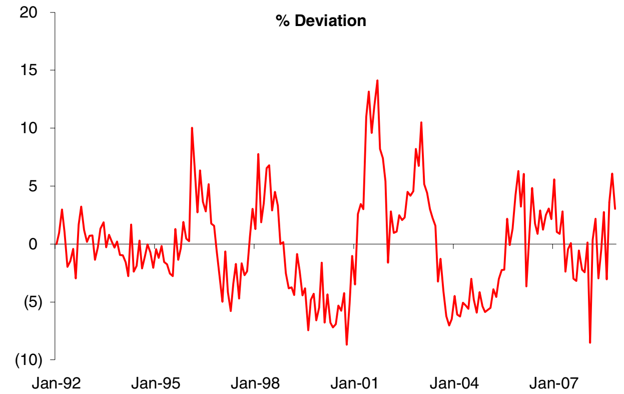

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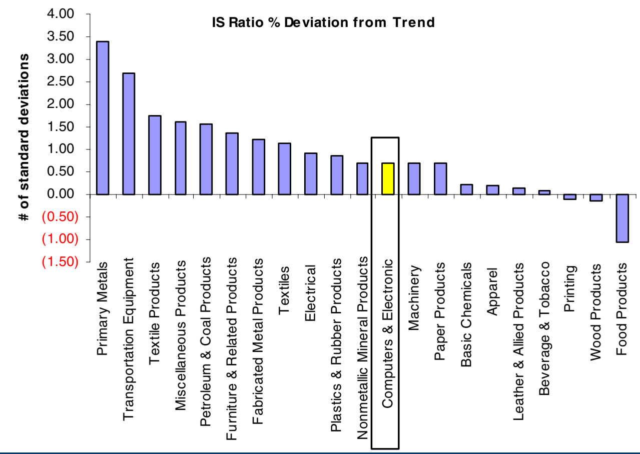
Figure 197: Compared with other sectors, the tech IS ratio looks reasonable



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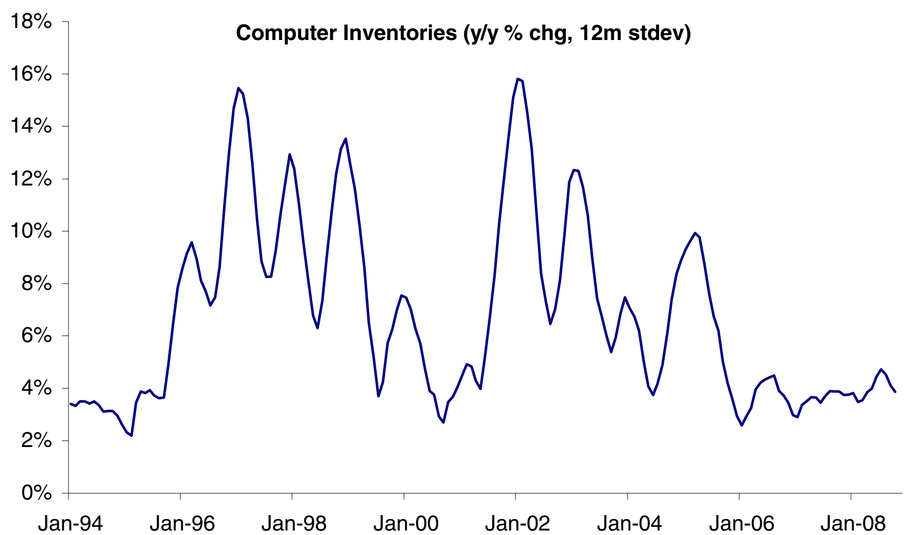
We note that the volatility of computer inventories has been muted.

Figure 198: Volatility of computer inventories has been muted



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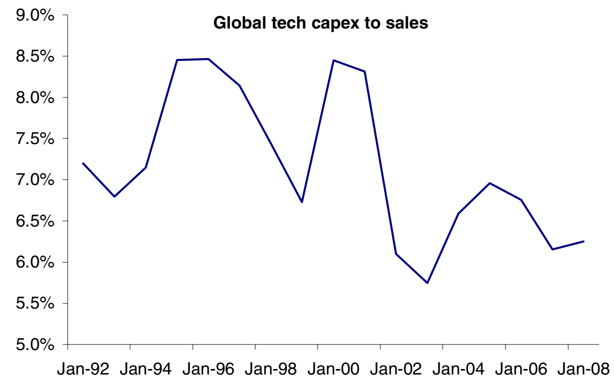
(b) the technology industry's control of capital expenditure has improved.

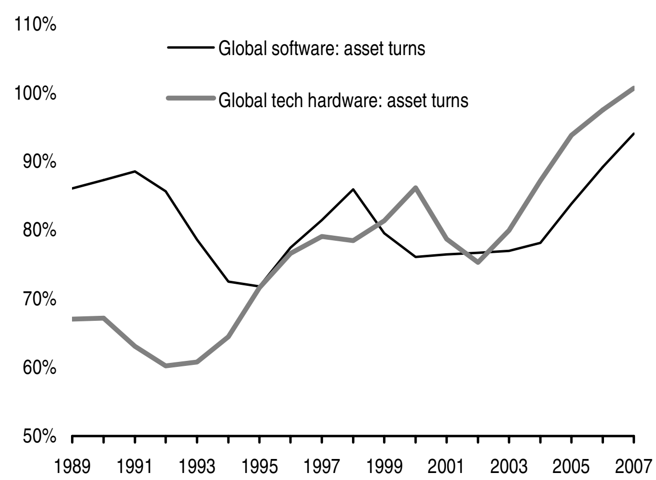
Much of this is reflected in the fact that this time around asset turns—rather than margins—have risen.

Figure 199: Global tech: Capex-to-sales and capex to depreciation



Source: Credit Suisse HOLT, Credit Suisse research

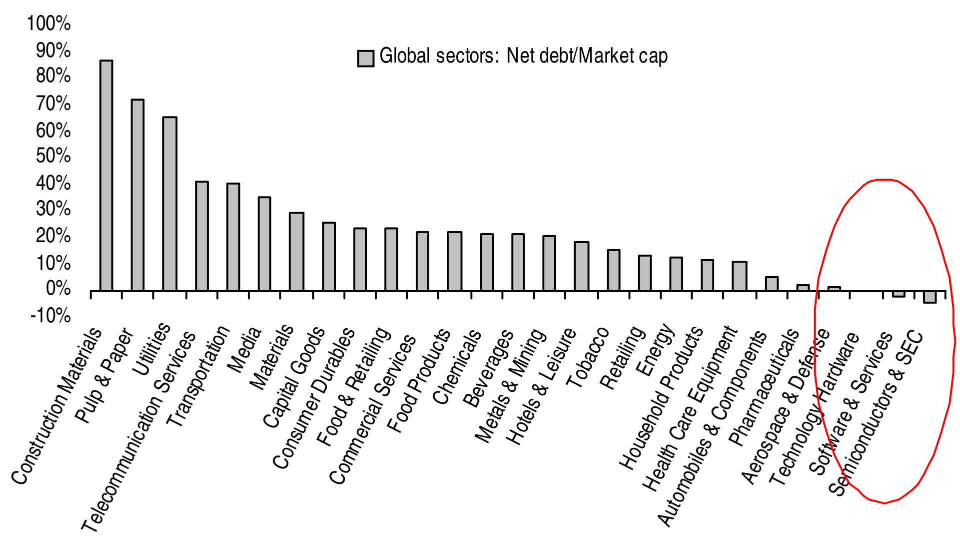
Figure 200: Global tech asset turns have improved



Source: Credit Suisse HOLT

(c) technology is lowly leveraged.

Figure 201: Net debt to market cap of global sectors (2008E)



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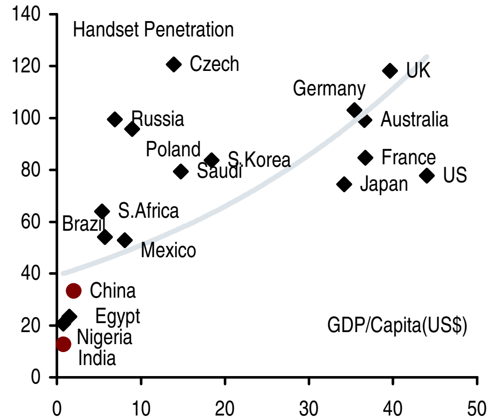
(6) Technology tends to have an abnormally high exposure to Non-Japan Asia (NJA)

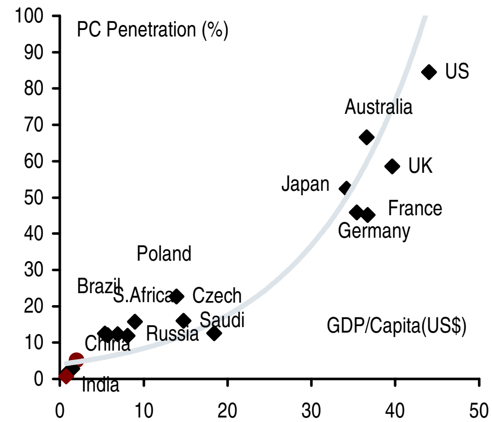
A high proportion of demand comes from NJA—a region on which we are relatively bullish. US semi-conductor companies, in particular, have very high exposure to NJA (50% of revenues for Intel, 48% for Texas Inst. and 46% for Applied). There is of course a low penetration rate of technology in Asia, which should make demand there less cyclical (Figure 202 and Figure 203).

Figure 202: Handset penetration (handsets as % of total population) - 2006



Source: Credit Suisse Asia Technology team

Figure 203: PC penetration (PC as % of total population) - 2006



Source: Credit Suisse Asia Technology team

(7) Tech beta has been declining—and is now below one

Indeed tech's one-year rolling beta is now the lowest it has ever been, making it a 'cyclical' defensive!

Figure 204: **Beta across US sectors**

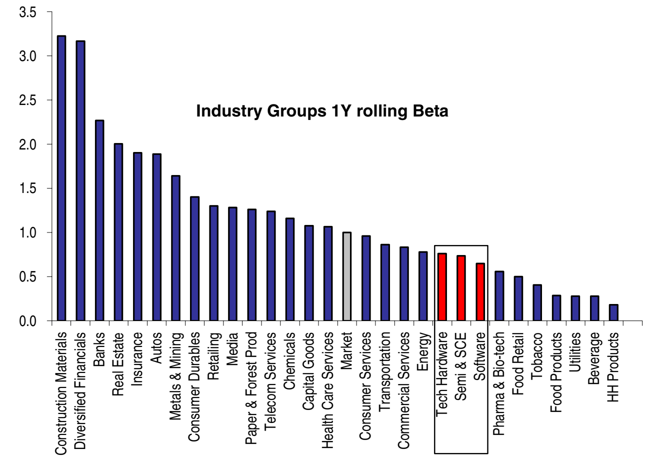


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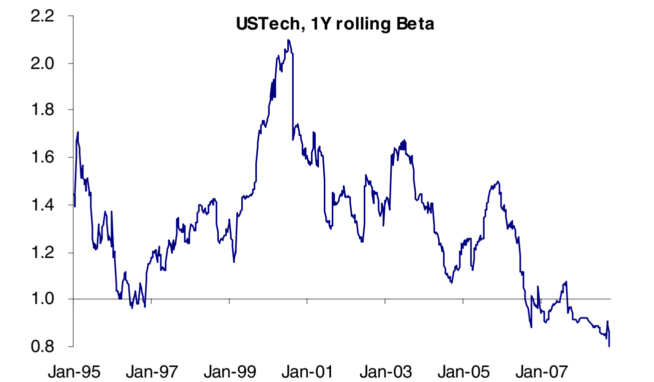
Figure 205: **US tech: One-year rolling beta**



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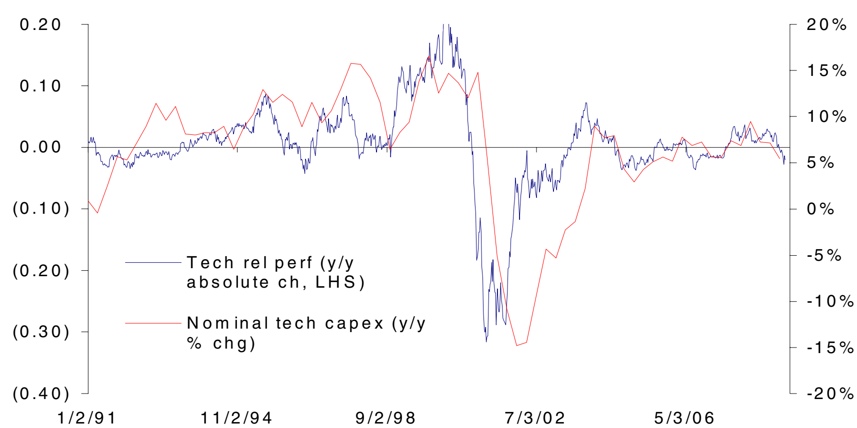
Potential negatives for the tech sector

(1) Relative performance of tech appears to track tech investment

Figure 206: **Tech performance seems to just follow tech capex**



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Of course the big concern about technology is that it is generally reliant on corporate discretionary spend—one of our largest underweights—but we believe there are a few reasons why tech could be more resilient than other 'corporate' spend areas:

a) technology investment tends to be 'productivity' enhancing as opposed to adding to capacity;

b) a lot of demand is replacement demand for software *(for SAP and Microsoft, maintenance accounts for about half of total revenues*);

c) technology's beta to capital spending is lower than most other sectors (Figure 207).

Figure 207: Beta of tech investment relative to GDP is muted compared with other capital goods sectors

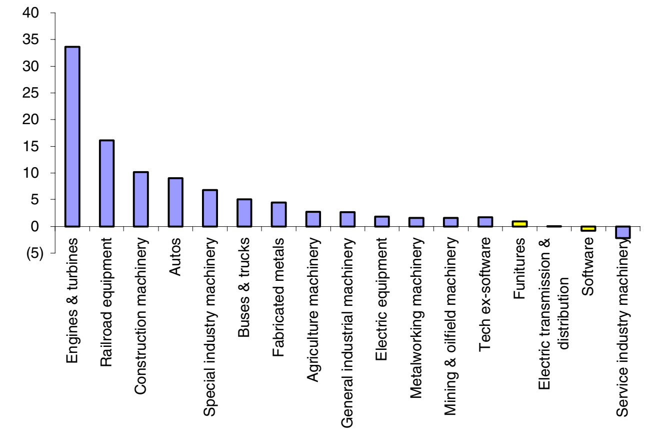

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Figure 208: US tech companies' current revenue exposure, % total

	Consumer	Business
IT Services	5%	95%
Software	20%	80%
PCs	34%	66%
Semiconductors	32%	68%
Wireless equipment	54%	46%
Wireline equipment	2%	98%
Internet	97%	3%
Average	**36%**	**64%**

Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Our least preferred area is non-handset related telecom equipment. We worry that the corporate discretionary areas of high-leverage customers will be hit hard (our telecoms equipment analyst Kulbinder Garcha points out that about a third of capital spending by telecoms could be discretionary).

Nokia theoretically benefits from its scale, the flexibility of its workforce and from being a play on the NJA consumer.

Within technology, we have three main themes:

First, we want to be focused on the consumer-related plays—as we highlight above corporate spend is clearly much more vulnerable than the consumer. This would highlight Qualcomm, Apple, Google, Acer and Nokia.

Figure 209: Tech companies with high exposure to the consumer that are Outperform-rated or are cheap on HOLT or P/B

		-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	% sales exposure to consumer	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Ebay Inc	100%	8.6	61%	-74%	1.7	-66%	11.5%	0.0%	-14.9	73.4	6.0	0.4	-0.2	-2.9	-4.2	0.5	-44.8	7.5	Neutral
Yahoo Inc	100%	27.3	194%	-49%	1.5	-58%	3.6%	0.0%	-2.7	-3.8	3.0	-3.5	-2.3	-6.8	-3.9	0.0	-42.9	4.0	Neutral
Google Inc	100%	14.0	99%	-47%	3.5	-47%	4.3%	0.0%	-8.4	16.6	5.0	2.0	-0.5	-1.0	-2.0	0.5	78.4	5.5	Outperform
Amazon.Com Inc	100%	34.7	196%	-4%	8.7	-77%	2.9%	n/a	2.3	-45.7	2.0	-0.3	-3.5	-12.0	-4.5	0.0	-35.7	3.0	Neutral
Qualcomm Inc	97%	15.3	129%	-26%	3.1	9%	4.1%	1.8%	-1.5	-11.4	2.0	1.3	0.0	-0.1	-0.3	0.5	70.4	2.5	Outperform
Apple Inc	85%	17.8	159%	16%	4.2	135%	4.7%	0.0%	3.2	-45.8	0.0	2.9	0.0	0.0	-0.1	0.5	57.6	0.5	Outperform
Acer Inc	50%	8.3	74%	1%	1.5	50%	12.0%	7.7%	9.3	-20.8	3.0	9.3	-0.6	-7.4	-1.6	0.5	68.4	3.5	Outperform
Htc Corporation	n/a	8.5	76%	15%	5.0	-9%	10.9%	8.5%	-6.8	17.2	6.0	1.6	2.7	-0.7	2.8	1.5	63.6	7.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Second, we would highlight areas where maintenance capital spending is a high proportion of sales—this backs the Outperform ratings on SAP and Microsoft.

Finally, we also highlight areas where product prices are below the cost of production. This is the case of DRAM, where about 80% of production is below the cash cost (hence the Outperform rating of Micron, which is trading at a 68% discount to replacement value) and Asian chip producers, where 50% of production is below cash cost.

Figure 210 and Figure 211 show European and US tech companies that are cheap on HOLT and on a relative P/B basis and have a Neutral or Outperform rating.

Figure 210: Europe tech companies that look cheap on HOLT and P/B

Name	-----P/E (12m fwd) ------ Abs	rel to Industry	rel to mkt % above/below average	------ P/B ------- Abs	rel to mkt % above/below average	Yield (08e) FCY	DY	HOLT Implied CFROI less 5-year average	Price, % change to best	Valuation score	----------- Momentum ------------- CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Tietoenator Oyj	6.3	52%	-26%	1.3	-45%	21.4%	6.8%	-9.4	91.0	7.0	-2.7	1.4	4.2	0.1	1.5	-30.8	9.5	Neutral
Alcatel-Lucent	6.2	52%	-36%	0.4	-66%	34.9%	0.6%	-4.4	175.4	6.0	3.9	-6.6	-16.6	-1.2	0.5	-15.2	7.5	Outperform
Csr Plc	12.1	68%	12%	0.7	-76%	18.8%	0.0%	-26.1	89.8	5.0	-14.6	0.3	1.0	16.8	1.5	-28.6	7.5	Neutral
Logitech Intl	9.2	82%	-2%	2.4	-29%	10.7%	0.0%	-8.6	19.0	6.0	-4.4	-3.8	-17.5	-9.8	0.0	-20.0	7.0	Neutral
Infineon Technolog	-2.0	-11%	-109%	0.2	-69%	n/m	0.0%	5.2	545.2	4.0	-12.7	NM	NM	-3.8	0.0	-53.3	5.0	Neutral
Soitec S.A.	-19.4	-108%	-181%	0.5	-71%	-48.6%	0.0%	1.9	4.0	4.0	-6.7	NM	NM	-11.0	0.0	-83.3	5.0	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

In Europe, our top pick purely on valuation grounds is Alcatel, which trades on 0.2x sales.

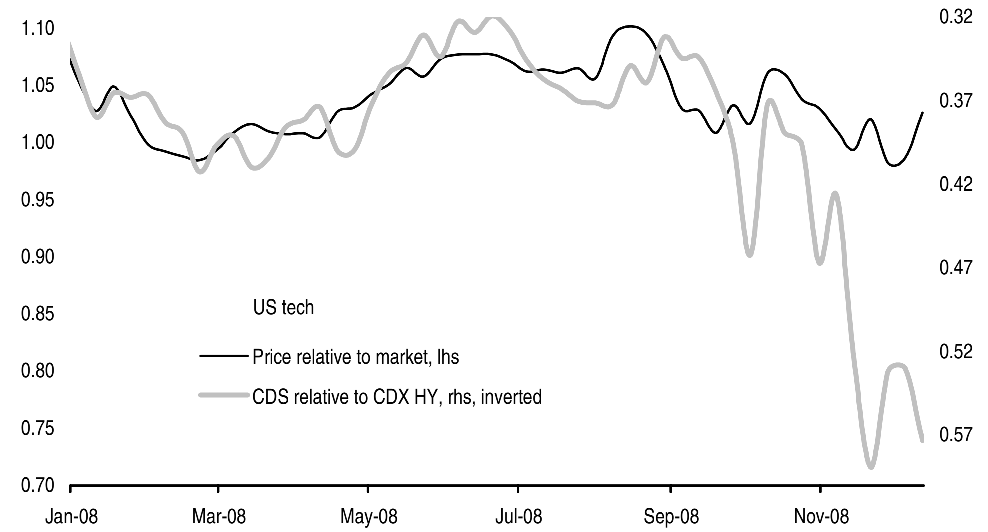
Figure 211: US tech companies that look cheap on HOLT and P/B

Name	-----P/E (12m fwd) ------ Abs	rel to Industry	rel to mkt % above/below average	------ P/B ------- Abs	rel to mkt % above/below average	Yield (08e) FCY	DY	HOLT Implied CFROI less 5-year average	Price, % change to best	Valuation score	----------- Momentum ------------- CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Intersil Corp -Cl A	12.7	71%	-21%	0.5	-42%	16.5%	5.4%	-3.4	10.5	7.0	2.3	-6.6	-15.7	-10.5	0.5	-8.3	8.5	Neutral
Digital River Inc	11.8	84%	-22%	1.4	-54%	6.9%	n/a	-0.3	21.0	7.0	6.6	-0.1	-8.4	-4.2	0.5	-33.3	8.5	Neutral
Molex Inc	12.4	n/a	-10%	0.9	-15%	10.7%	n/a	-0.8	4.3	7.0	-1.6	0.0	0.0	0.0	0.0	-40.0	8.0	Neutral
Avnet Inc	6.2	n/a	-26%	0.6	-34%	18.1%	n/a	-1.6	24.4	7.0	0.4	0.0	0.0	0.0	0.5	25.0	7.5	Neutral
Jabil Circuit Inc	5.5	n/a	-47%	0.5	-67%	9.4%	n/a	-3.0	81.8	7.0	0.4	0.0	-0.3	-0.1	0.5	37.5	7.5	Outperform
Ebay Inc	8.6	61%	-74%	1.7	-66%	11.5%	0.0%	-14.9	73.4	6.0	0.4	-0.2	-2.9	-4.2	0.5	-44.8	7.5	Neutral
Computer Sciences Corp	7.0	57%	-29%	0.8	-40%	17.4%	0.0%	-0.2	35.8	6.0	2.3	-3.9	-5.3	-2.9	0.5	-69.2	7.5	Neutral
Akamai Technologies Inc	8.1	57%	-64%	1.6	-54%	9.4%	n/a	1.2	45.3	6.0	7.3	-0.2	-2.1	-0.9	0.5	-12.0	7.5	Neutral
Teradyne Inc	-22.7	-127%	-291%	0.6	-63%	3.4%	n/a	-0.3	33.3	6.0	0.2	-1.4	-52.6	-7.2	0.5	-14.3	7.5	Neutral
Adobe Systems Inc	12.6	114%	-5%	2.8	-31%	8.6%	0.0%	-10.1	43.7	5.0	4.4	2.6	5.0	-0.3	1.5	-15.4	7.5	Outperform
Arrow Electronics Inc	7.3	n/a	-8%	0.5	-40%	13.7%	n/a	-3.1	22.0	7.0	-0.9	-0.9	-12.4	-3.1	0.0	33.3	7.0	Neutral
Maxim Integrated Products	17.4	97%	18%	1.1	-66%	7.4%	6.4%	-7.1	18.0	6.0	-1.8	0.0	-0.5	0.0	0.0	-23.8	7.0	Neutral
Juniper Networks Inc	13.9	118%	-53%	1.6	-8%	7.6%	0.0%	-5.2	80.4	5.0	6.9	-0.1	1.8	-0.4	1.0	-6.7	7.0	Neutral
Broadcom Corp	12.7	71%	-54%	2.1	-15%	9.5%	0.0%	-10.1	119.6	6.0	4.6	-1.0	-2.3	-2.2	0.5	3.2	6.5	Outperform
Amphenol Corp	10.2	n/a	1%	2.6	-33%	10.1%	0.4%	-8.2	35.8	6.0	0.8	-2.5	-2.9	-1.9	0.5	27.3	6.5	Outperform
Memc Electronic Matrials Inc	5.0	28%	-48%	1.7	-71%	15.7%	0.0%	-6.7	103.2	6.0	6.7	-4.4	-16.9	-9.7	0.5	70.0	6.5	Neutral
Oracle Corp	10.8	98%	-22%	3.7	-43%	8.6%	0.0%	-12.6	58.7	6.0	-1.5	-1.9	-1.7	-5.0	0.0	44.8	6.0	Neutral
Citrix Systems Inc	13.5	123%	-19%	2.4	-11%	5.0%	0.0%	-9.3	36.2	5.0	0.2	0.0	3.1	-0.4	1.0	9.7	6.0	Outperform
Autodesk Inc	11.1	101%	-8%	3.3	-17%	10.3%	0.0%	-9.1	3.4	5.0	-3.8	-8.5	-14.3	-6.3	0.0	-47.4	6.0	Neutral
Micron Technology Inc	-2.4	-13%	-121%	0.3	-80%	-77.2%	0.0%	-1.9	173.6	5.0	-4.6	NM	NM	-0.6	0.0	-10.0	6.0	Outperform
Google Inc	14.0	99%	-47%	3.5	-47%	4.3%	0.0%	-8.4	16.6	5.0	2.0	-0.5	-1.0	-2.0	0.5	78.4	5.5	Outperform
Cognizant Tech Solutions	11.1	91%	-46%	2.9	-58%	4.6%	0.0%	-6.5	8.2	5.0	-0.7	0.0	0.2	-0.1	0.5	47.4	5.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

The relative price performance of US tech companies has held up better than their relative CDS (Figure 212). This means that perhaps it is better to buy the CDS than the equity!

Figure 212: Price relative of US tech versus relative CDS spread



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Defensives:

Which defensives do we like?

Below we score defensive sectors on the following criteria:

(i) correlation with OECD lead indicators;

(ii) leverage (net debt as % of market cap);

(iii) historical volatility of CFROI® and EPS;

(iv) correlation of sector EPS with lead indicators; and

(v) earnings momentum.

The most defensive sectors on these criteria are: pharma, food producers, tobacco and household products. Software and telecoms rank just below this.

Figure 213: **European sectors' defensiveness scorecard**

European Sector	OECD LI & Price rel: correlation	Net debt / market cap	Historical volatility		OECD LI & earnings correlation	Earnings momentum	Overall Rank
			CFROI	EPS			
Pharma	-0.52	8%	8%	13%	15%	4%	1
Food Producers	-0.42	18%	13%	13%	-8%	-6%	2
Tobacco	-0.50	19%	25%	20%	-2%	12%	3
Software	-0.10	-4%	19%	191%	-13%	-14%	4
HH Products	-0.34	5%	26%	25%	22%	-11%	5
Telecoms	-0.24	56%	10%	89%	-16%	-4%	6
Energy	-0.31	8%	26%	34%	18%	-19%	7
Beverages	-0.29	40%	14%	16%	11%	-15%	8
Food Retailing	-0.02	30%	11%	20%	8%	-10%	9
Un-regulated Utilities	-0.39	45%	27%	14%	9%	-7%	10
Utilities	-0.39	45%	25%	14%	9%	-7%	11
Hotels & Leisure	0.27	21%	7%	24%	-21%	-12%	12
Healthcare Equip	-0.04	24%	5%	65%	59%	-16%	13
Commercial Services	0.04	20%	11%	20%	39%	-6%	14
Automobiles	0.19	40%	24%	37%	-17%	-31%	15
Materials	0.26	26%	25%	30%	-24%	-22%	16
Media	0.08	44%	24%	129%	-3%	-16%	17
Retailing	0.24	18%	15%	25%	38%	-26%	18
Technology Hardware	0.19	-9%	51%	365%	13%	-21%	19
Semiconductors	0.40	2%	140%	204%	-7%	-38%	20
Regulated Utilities	0.12	104%	18%	24%	9%	-7%	21
Consumer Durables	0.43	25%	6%	313%	57%	-24%	22
Capital Goods	0.58	42%	17%	163%	-2%	-18%	23
Transport	0.42	52%	14%	34%	10%	-12%	24

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If we look at valuation among defensive sectors based on FCF yield, price to book and value-to-cost, telecoms is the cheapest sector and HH products the most expensive one (Figure 214).

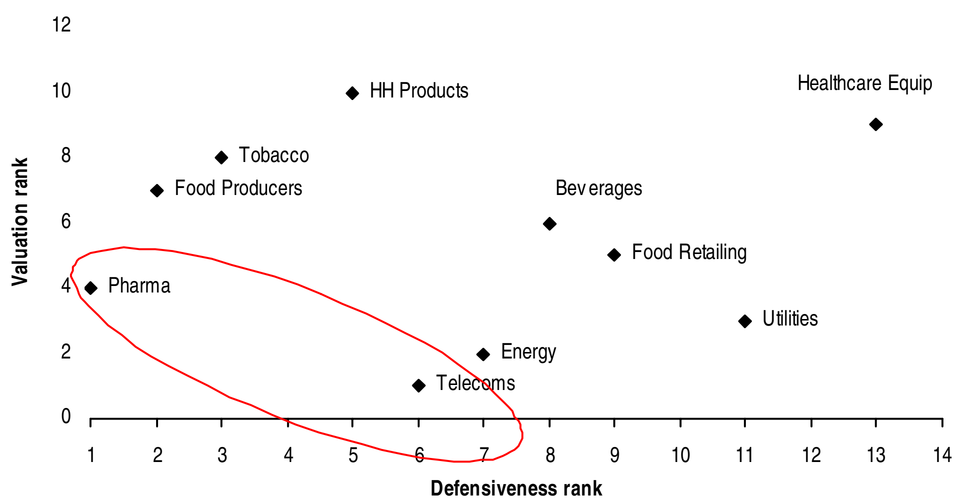
Figure 214: European defensives valuation scorecard

Pan Eur Sectors	FCFY 2008e	P/B rel	VCR	Overall rank
Telecoms	13.2%	116%	111%	1
Energy	6.0%	117%	93%	2
Utilities	3.4%	125%	97%	3
Pharma	7.5%	207%	150%	4
Food Retailing	1.5%	141%	128%	5
Beverages	6.4%	155%	204%	6
Food Producers	6.2%	237%	191%	7
Tobacco	6.9%	280%	383%	8
Healthcare Equip	5.6%	205%	200%	9
HH Products	5.9%	284%	242%	10

Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Factset, Credit Suisse research. For Energy, the FCF yield is calculated assuming an oil price of US$50pb

Figure 215 shows a scatter graph combining defensiveness and valuation score: Telecom and Pharma offer the best mix.

Figure 215: Valuation and defensiveness score—European sectors (low score is a positive)



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Factset, Credit Suisse research.

In Appendix 8 we show the defensiveness and valuation scorecards for the US.

We reduce the size of our overweight in food retailing, which on both valuation and defensive criteria ranks less well. On 12 November, we reduced food producers from overweight to benchmark, largely because the valuation had become stretched.

Figure 216: European food producers' P/E relative to other defensives is very extended

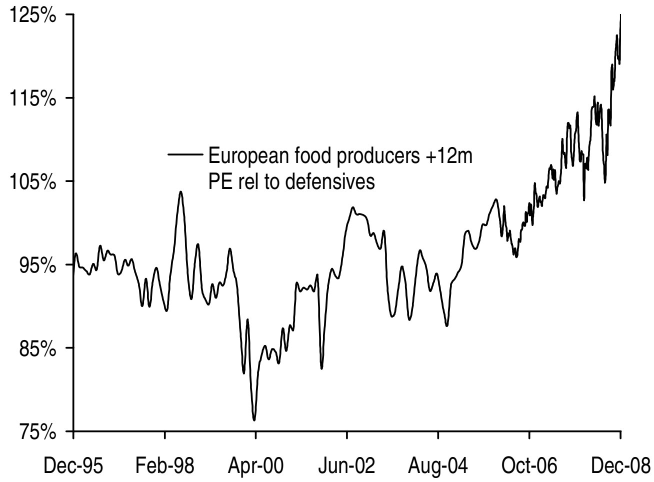


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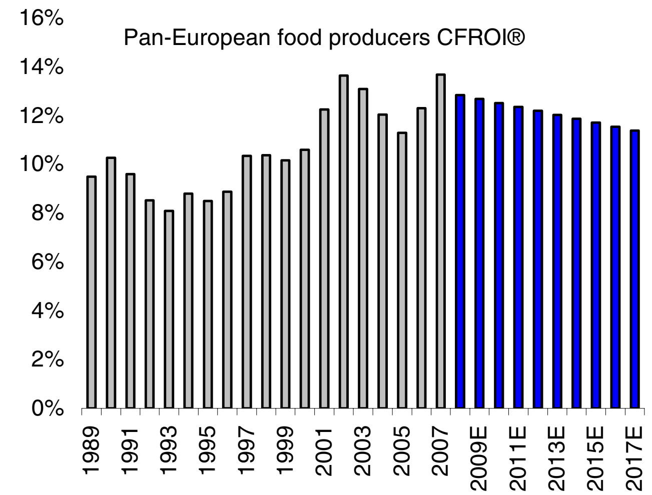
Figure 217: European food producers also do not look attractive on HOLT (assuming real asset growth of 1.5%)



Source: Credit Suisse HOLT

Figure 218: Pan-European food on HOLT: Model inputs and outputs

Sector name	CFROI®		Implied CFROI® fade (percentage points)	Model inputs		Historical average (15 years)	
	2008E	Required FY10		Length of fade (y)	Assumed RAGR	CFROI®	RAGR
Pan-Europe food producers	12.8%	11.4%	-1.5%	10	1.5%	10.9%	2.1%

Source: Credit Suisse HOLT

In addition, we were worried about the EMEA exposure (which is 4% to 12% of sales).

Telecoms: Stick to a small overweight

We stick to an overweight of telecoms for the following reasons:

(a) This sector has historically been quite defensive if we look at the correlation with lead indicators and the income elasticity of demand (which has been very low).

Figure 219: **Telecoms have a low correlation with lead indicators**

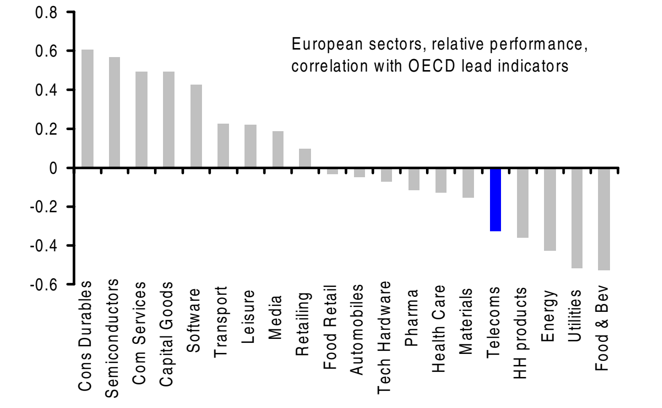


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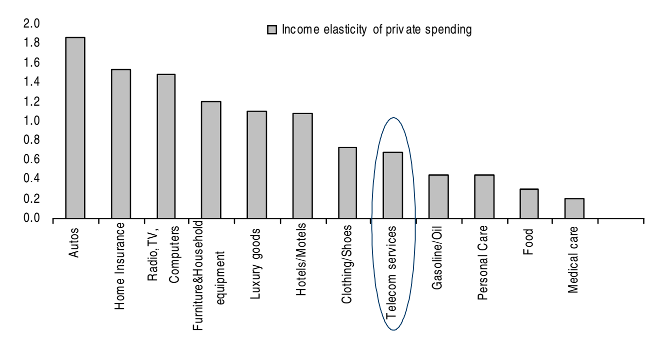
Figure 220: **Income elasticity**



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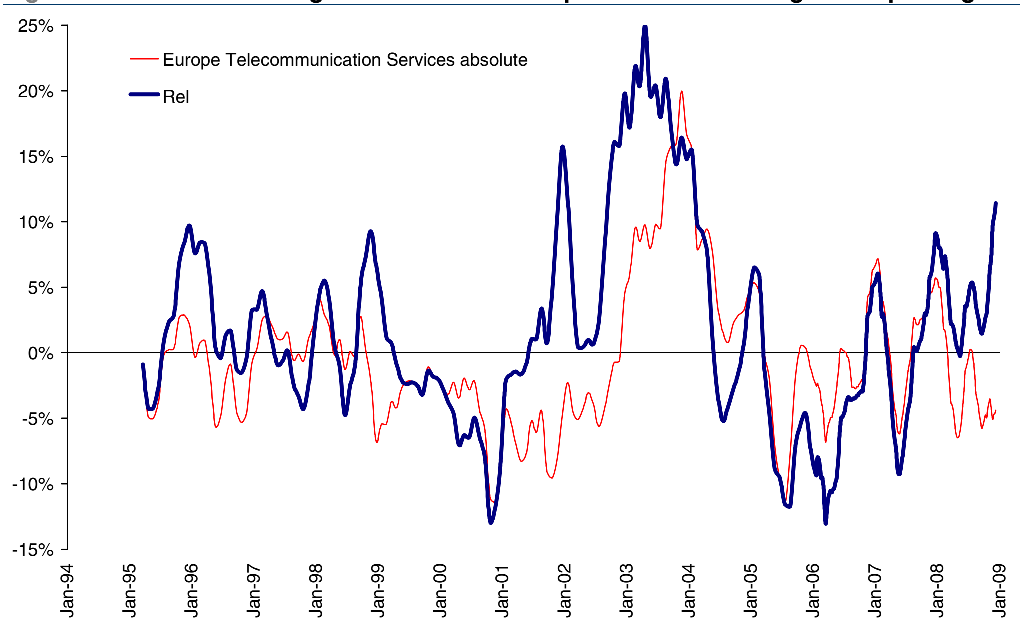
It also ranks sixth out of 24 sectors on our defensiveness scorecard.

(b) Relative earnings momentum of telecoms is strong and rising. We believe that the European market EPS could be revised down 30–50%. This is likely to be far less than for telecoms.

Figure 221: **Relative earnings momentum of European telcos is strong and improving**



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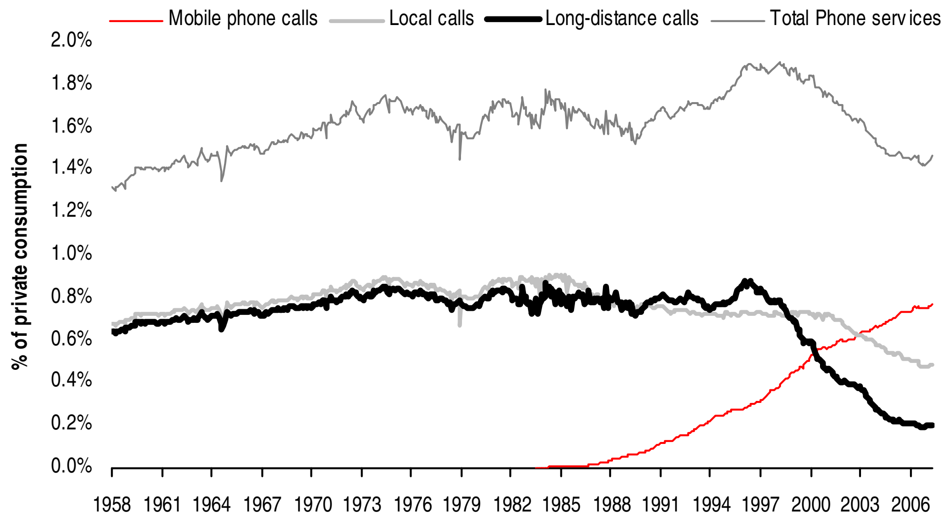
(c) The sector's cyclicality may have been overstated with the telecom spend as a proportion of national income at a 30-year low (the increase in wireless has been offset by a fall in long distance and local calls).

Figure 222: **Consumers have only limited spend on telecoms**



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(d) Telecoms has an abnormally high dividend yield and we believe that dividend will be one of the best-performing styles.

Telecoms accounts for 13% of dividends in the stock market (if we exclude financials given that its dividends are vulnerable).

Figure 223: **European telecoms has the fourth-highest FCF yield of all the sectors in 2008E**

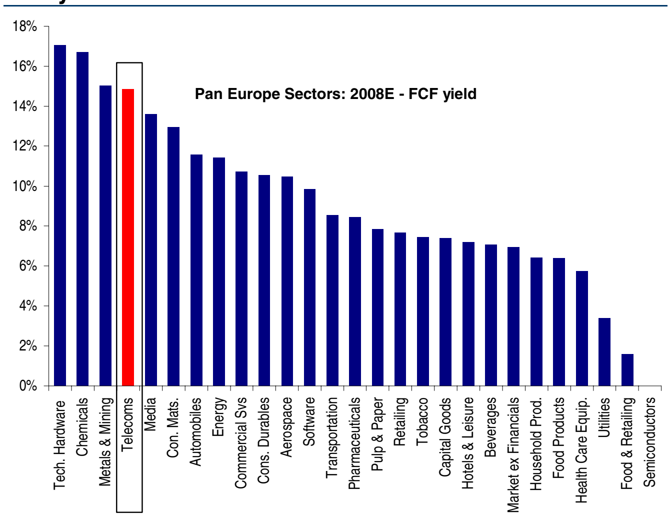

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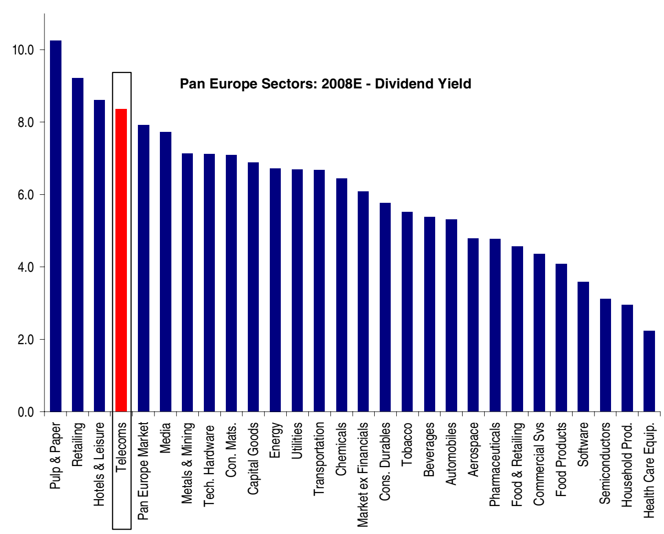
Figure 224: **. . . and the fourth-largest dividend yield**



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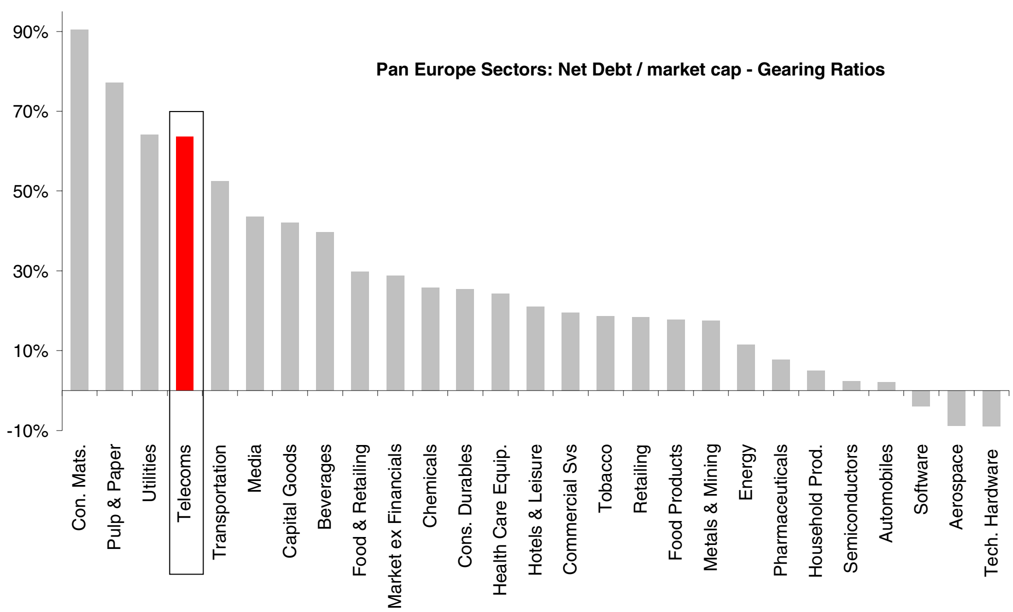
We show on page 59 why high dividend yield as a style should outperform.

(e) The sector has high leverage but this is an asset if credit spreads fall. We only want to buy leverage if there is high FCF as well.

Figure 225: **European sectors' leverage (net debt as % of market cap, 2008E)**



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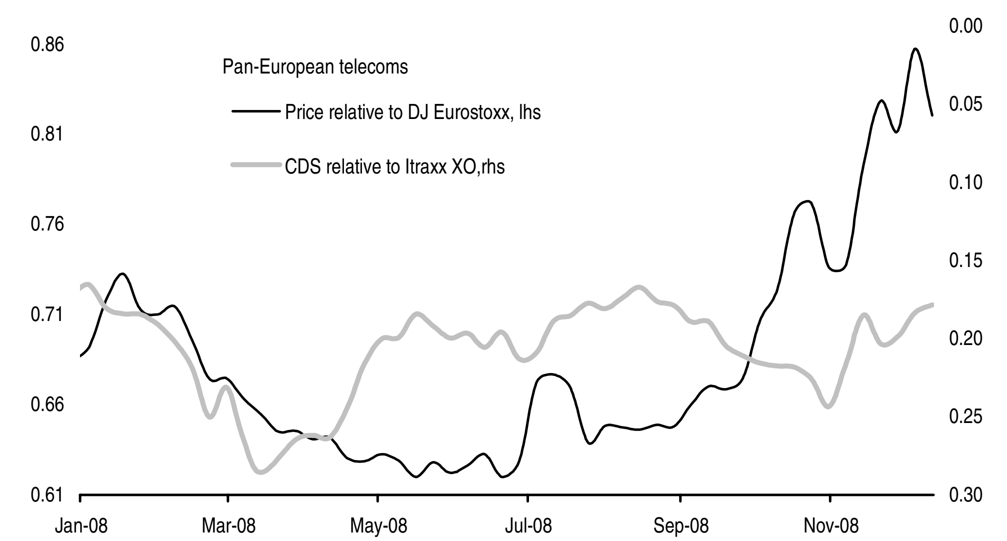
Low leverage as a style has outperformed by nearly 50% over the past year, but we believe that if credit spreads fall, then leverage as a style will no longer underperform and that should be to the benefit of telecoms. We show on page 66 that leverage as a style is very closely correlated to credit spreads.

However, we note that telecoms' price relative now looks extended when compared with the relative CDS spreads.

Figure 226: **Telecoms' price relative is extended relative to the CDS relative**



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(f) The telecom sector is used to falling prices

Figure 227: UK telecom service price deflation (yoy %)

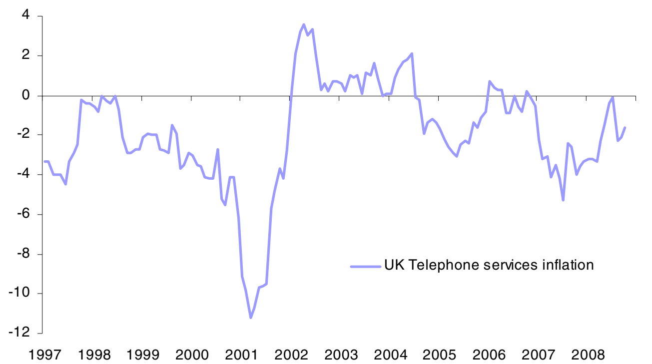

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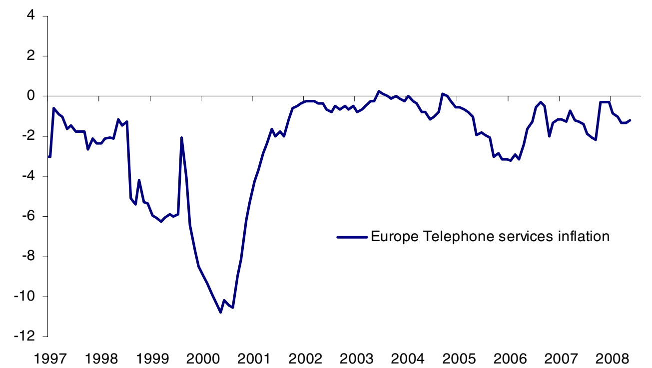
Figure 228: European telecom service price deflation (yoy %)



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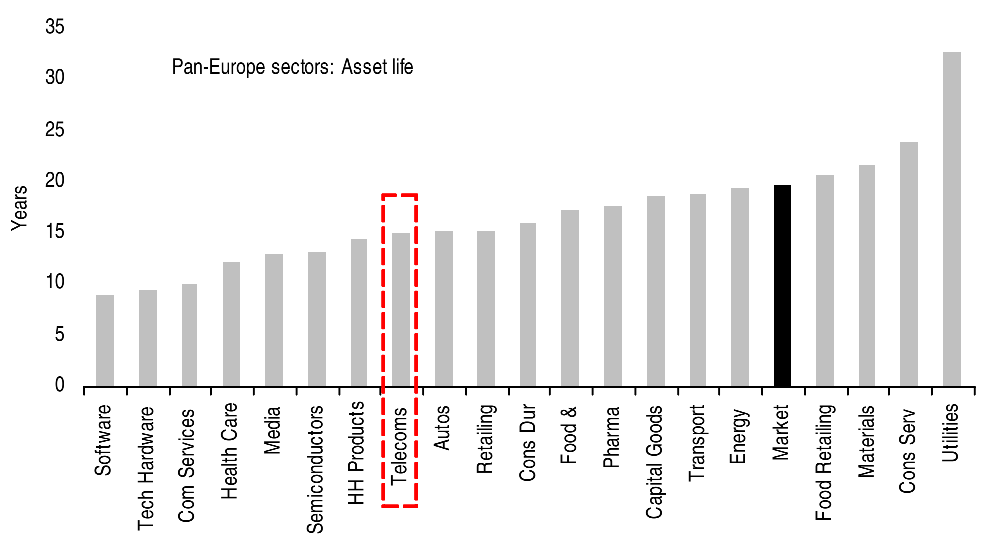
Oddly enough the telecom sector has a relatively short asset life (Figure 229)—15 years versus a norm of 20 years.

Figure 229: Europe sectors: Asset life



Source: Credit Suisse HOLT, Credit Suisse research

These two characteristics are useful into deflation as we argued in our theme piece.

(g) Moreover, telecoms can resort to self help. Vodafone and TEF have said that a very high proportion of their capital spending is discretionary.

(h) Valuation is OK

Telecoms look quite cheap relative to the other defensive sectors, as we can see on our valuation scorecard on page 98. It is actually the cheapest defensive sector.

Figure 230: **Europe telecom 12m fwd P/E rel to market ex financials**

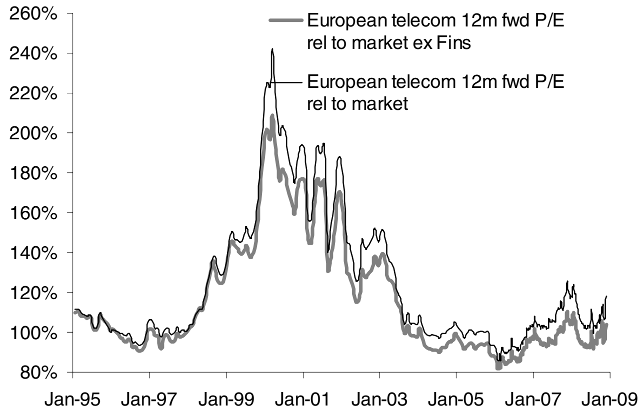
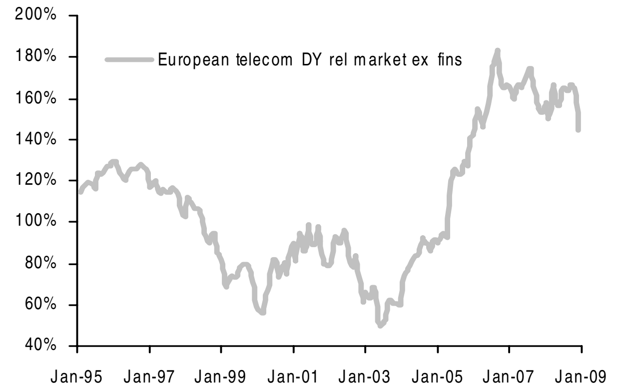


Figure 231: **Europe telecom 12m fwd D/Y rel to market ex financials**



Telcos' valuation against regulated utilities (excluding energy utilities) on P/E and P/B still looks quite attractive.

Figure 232: **European Telecoms' P/E relative to regulated utilities**

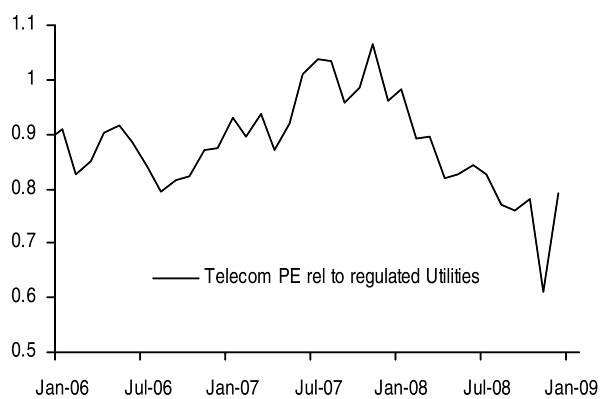


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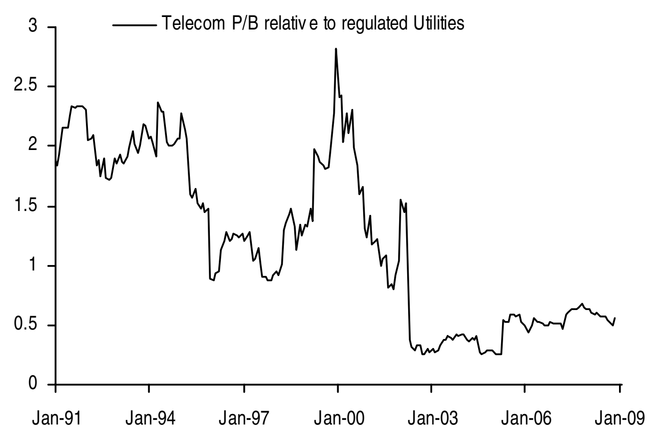
Figure 233: **European Telecoms' P/B relative to regulated utilities**



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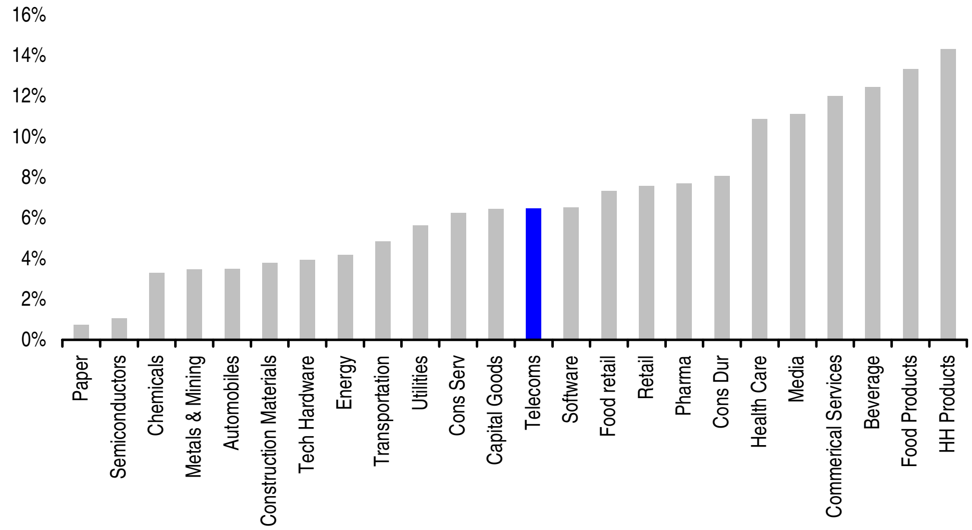
If we look at HOLT, the implied CFROI® is now similar to that of utilities!

Figure 234: Pan-European sectors on HOLT: Implied CFROI ®



Source: Credit Suisse HOLT, Credit Suisse research

Finally, European telecoms are still looking cheap versus US telecoms on a P/E or dividend yield basis.

Figure 235: European telecom 12m fwd P/E relative to US telecom

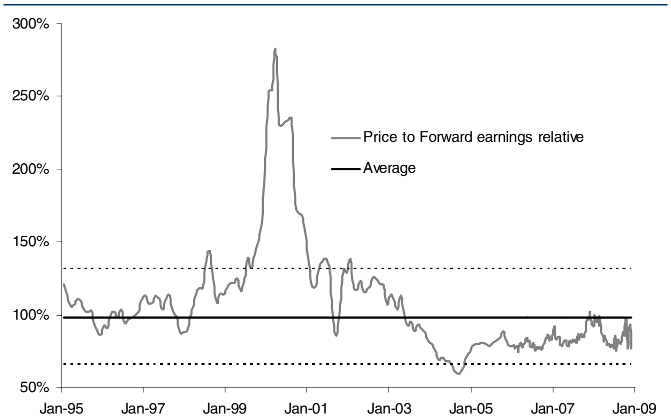


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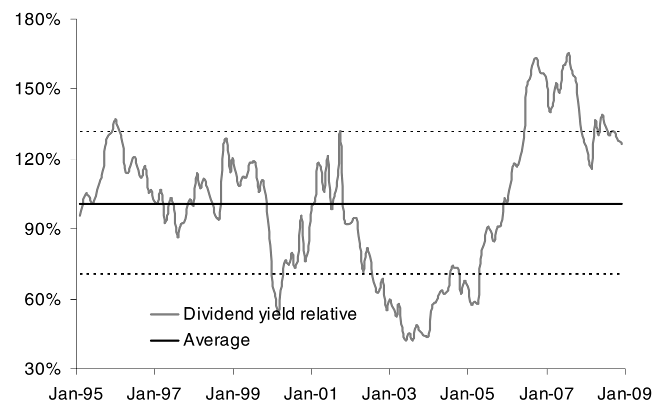
Figure 236: European telecom dividend yield relative to US telecom (last reported)



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We can see that European telcos are trading on a 23% P/E discount to its US sector peers (using 12m forward consensus numbers) compared with a historical discount of 9%. In addition, the European telecoms sector has a dividend yield of 6.9% compared with 5.5% for its US peer group.

Figure 237: European and US telecoms on 12m fwd P/E and dividend yield

	Europe	US	Europe rel US	LT Average
12m fwd P/E	9.0	11.6	77%	91%
DY	6.9	5.5	126%	103%

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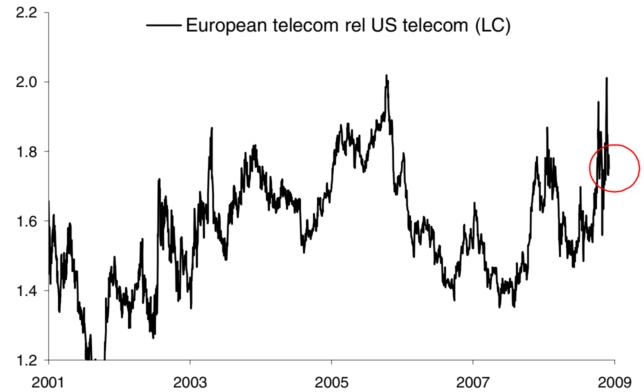
Figure 238: European Telecom relative to US Telecom price performance



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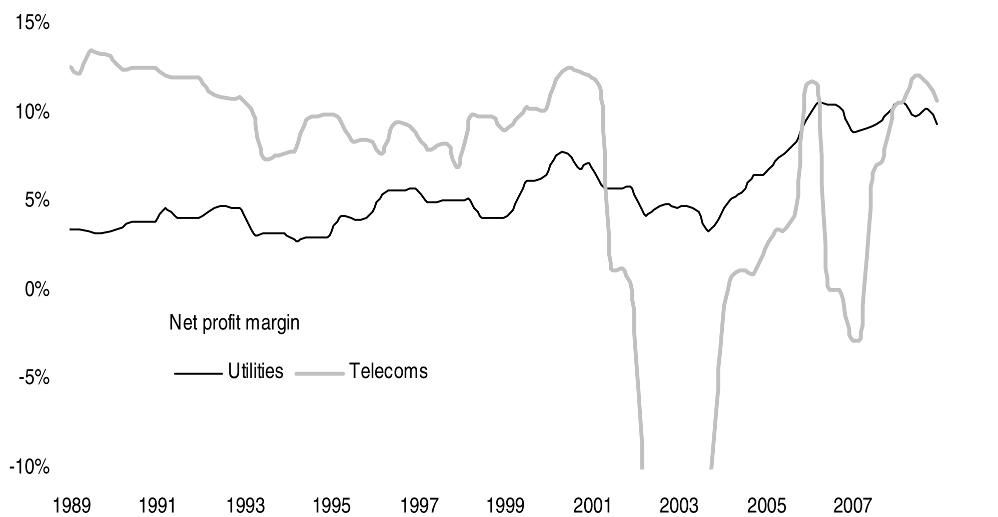
We acknowledge that there is an implicit margin risk, but telecom and utilities margins are now similar—something that was not the case historically (Figure 239).

Figure 239: Pan-European telecoms versus utilities: Net profit margins are very similar!



Source: Credit Suisse HOLT, Credit Suisse research

We believe there could even be a number of catalysts for further outperformance:

a) If the regulator starts to ease up on the sector as levels of CFROI® have fallen to what we see as reasonable levels (this is for example happening in the UK) and in some markets (eg, DSL in Germany) there is already significant competition (where, for example, DT has only a 40% market share).

b) The move to fibre could allow the sector to operate with less real estate and fewer people. This puts pressure on unbundlers to consolidate.

c) The increasing shortage of available capital, especially with the move to quadruple play/IPTV, could allow the incumbents to win market share off the second-tier players (who may not be able to get the financing).

If the credit crisis worsens, telecoms earnings should be less affected than those of the market and competition between telecoms should ease (as the incumbents will likely win market share from second-tier operators and there is a less cut-throat move to the next generation of technology). If credit spreads improve, telecoms, which have high net debt to market cap, should benefit. Although a sharp fall in credit spreads would mean telecoms would likely underperform, they would underperform less than other defensives in our opinion because of their relatively high leverage.

Figure 240 shows telecoms stocks that screen well on our aggregate scorecard.

Figure 240: European telcos stocks that look attractive on our aggregate scorecard

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Vodafone Group	9.4	79%	-15%	0.9	-75%	12.9%	5.9%	-4.6	10.2	7.0	-1.1	-0.1	0.2	0.2	1.0	9.1	8.0	Neutral
Bt Group	6.9	67%	-10%	2.2	30%	10.0%	8.9%	-0.1	6.1	6.0	-0.3	-2.5	-11.1	0.7	0.5	-51.7	7.5	Neutral
Freenet Ag	4.1	35%	n/a	0.8	n/a	43.5%	0.9%	-8.4	178.4	6.0	5.9	-9.4	-13.8	34.6	1.0	41.2	7.0	NR
Colt Telecom Gp Sa	7.8	76%	n/a	0.5	n/a	3.7%	0.0%	-4.5	294.2	4.0	1.5	8.4	13.7	5.0	2.0	-60.0	7.0	Neutral
France Telecom	9.5	92%	14%	1.8	1%	12.1%	7.2%	-0.9	15.9	5.0	0.4	0.3	0.8	0.0	1.5	13.5	6.5	Neutral
Teliasonera Ab	8.6	83%	-14%	1.6	56%	9.6%	5.1%	-1.4	18.3	5.0	-0.3	0.4	1.6	0.1	1.5	10.3	6.5	Neutral
Tele2 Ab	8.3	80%	-40%	1.3	37%	5.8%	5.4%	-0.6	9.4	5.0	3.5	1.3	-0.5	-2.3	1.0	36.0	6.0	Neutral
Elisa Corporation	8.9	86%	-12%	2.2	77%	9.9%	7.4%	5.8	-21.6	4.0	2.3	0.9	-3.3	-1.8	1.0	-36.0	6.0	Neutral
Deutsche Telekom	13.7	133%	17%	1.3	42%	15.1%	6.8%	0.6	2.7	3.0	0.4	1.4	0.7	0.1	2.0	-4.8	6.0	Outperform
Mobistar	11.8	99%	28%	11.9	119%	8.2%	7.4%	6.8	-27.2	3.0	2.8	0.8	1.3	0.7	2.0	-23.8	6.0	Outperform
Telekom Austria(Ta	9.7	94%	-34%	2.1	51%	13.5%	6.6%	3.0	-40.9	4.0	-0.6	2.5	1.7	-0.2	1.0	42.9	5.0	Neutral
Versatel Ag	-25.1	-244%	n/a	1.3	n/a	-6.6%	0.0%	-0.4	-13.0	3.0	-0.5	NM	NM	-0.1	0.0	-76.5	4.0	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Our European telecoms team would highlight the following stocks: DT, Telefonica, Swisscom, Inmarsat, Mobistar.

Drugs:

UK drugs appear to be cheap on dividend yield relatives and HOLT.

Figure 241: UK drugs DY relative to market ex financials

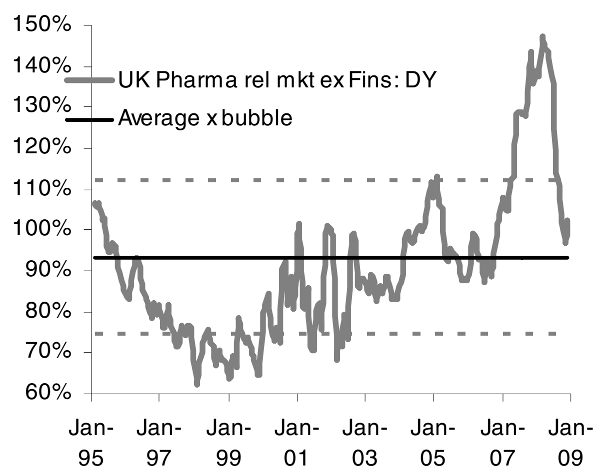


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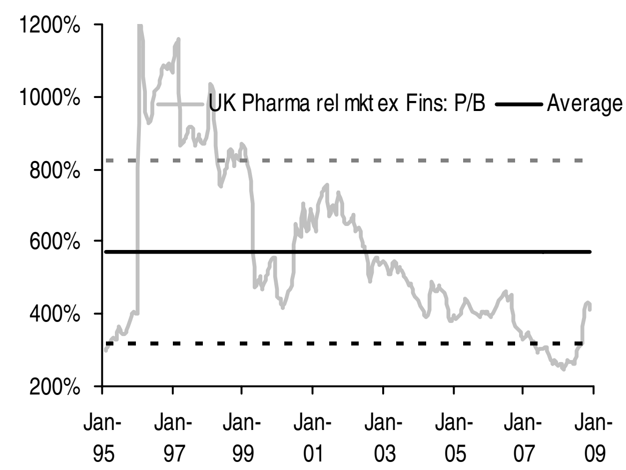
Figure 242: UK drugs P/B relative to market ex financials



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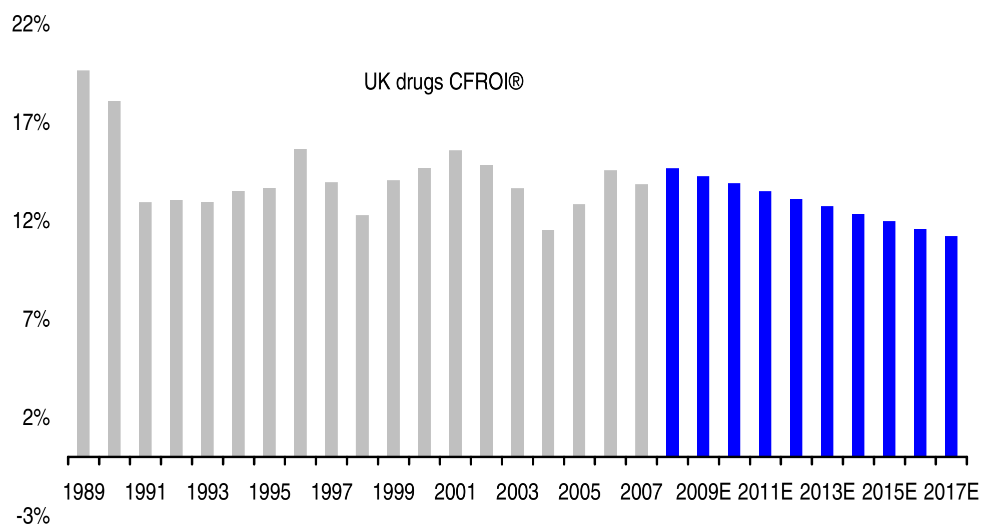
On HOLT, UK drugs require a FY10 CFROI® of 11.2% (assuming a real asset growth of 2%), below the current level of 14.6% and the 15-year average of 13.8%.

Figure 243: UK drugs on HOLT



Source: Credit Suisse HOLT, Credit Suisse research

Figure 244: **UK drugs on HOLT: Model inputs and outputs**

Sector name	CFROI®		Implied CFROI fade	Model inputs			Historical average (15 years)	
	2008E	Required FY5		Length of fade (y)	Assumed RAGR	Real cost of capital	CFROI®	RAGR
UK drugs	14.6%	11.2%	-3.4%	10	2.0%	6.0%	13.8%	10.4%

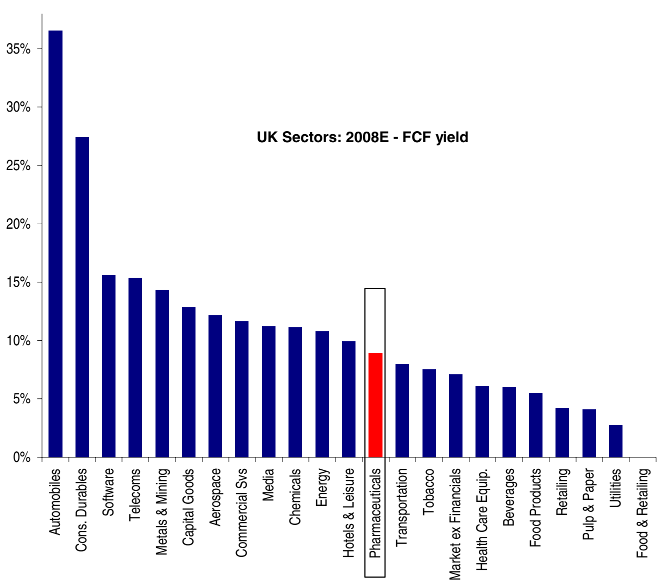
Source: Credit Suisse HOLT, Credit Suisse research

The UK drugs sector enjoys the following attractive features:

(a) scoring at the top of our defensive scorecard;

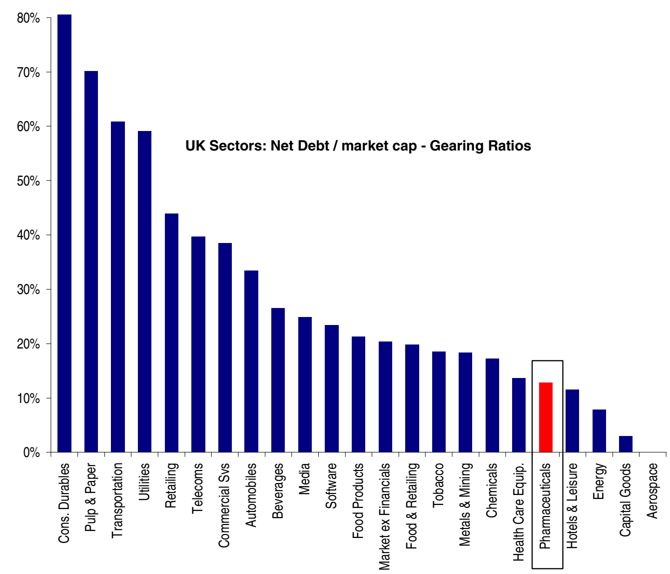
(b) having a relatively high 2008E FCF yield (9%);

Figure 245: **UK sectors: FCF yields (2008E)**



Source: © Datastream International Limited ALL RIGHTS RESERVED, I/B/E/S, Credit Suisse research

Figure 246: **UK sectors' net debt as % of market cap (2008E)**



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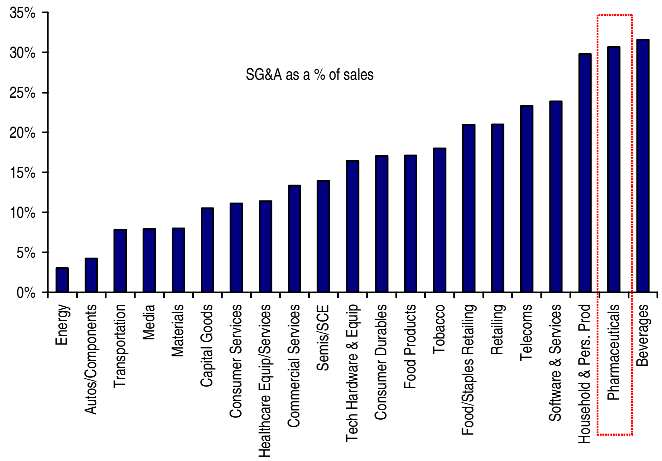
(c) low leverage (13% net debt as a proportion of market cap in 2008E);

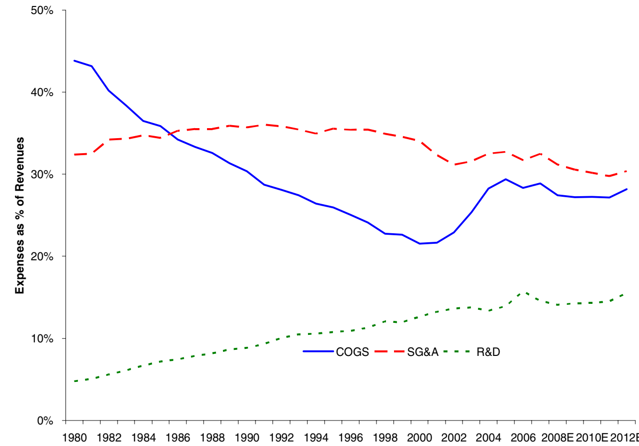
(d) self-help potential (cost cutting tends to feed through to the corporate rather than the consumer); with S,G&A and R&D nearly triple the market norm (Figure 247), with only relatively limited reduction in S,G&A over the past decade.

Figure 247: US pharmaceuticals has one of the highest SG&A as a % of sales (last reported)



Source: Worldscope, Credit Suisse research

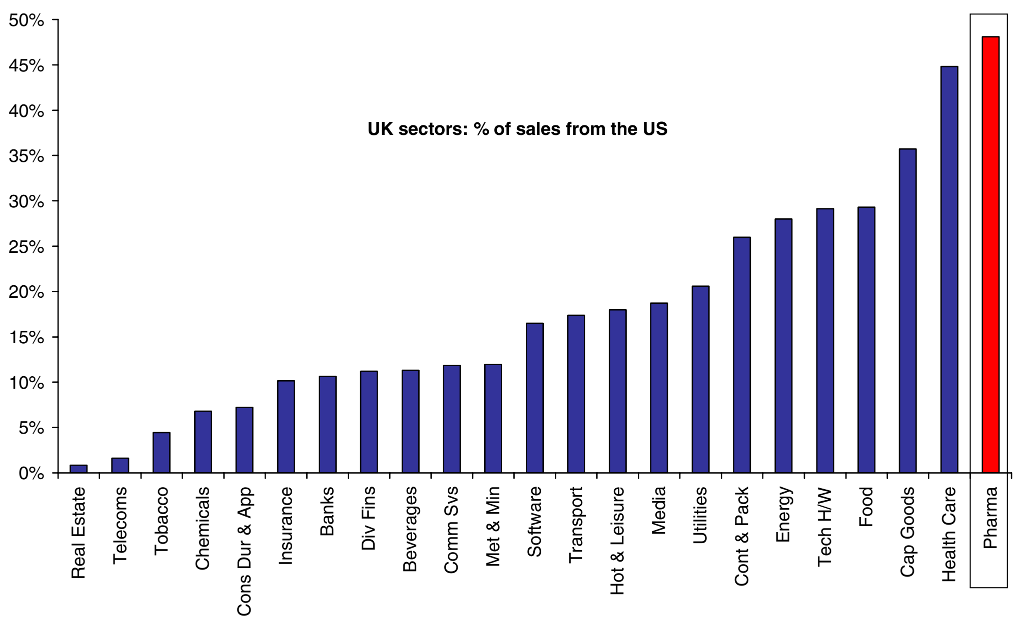
Figure 248: SG&A and R&D as a % of sales for pharma



Source: US Pharma team estimates, Company data, Credit Suisse research

(e) it is a winner from sterling weakness (being one of the biggest overseas earners).

Figure 249: UK sectors: % of earnings from overseas (last reported)



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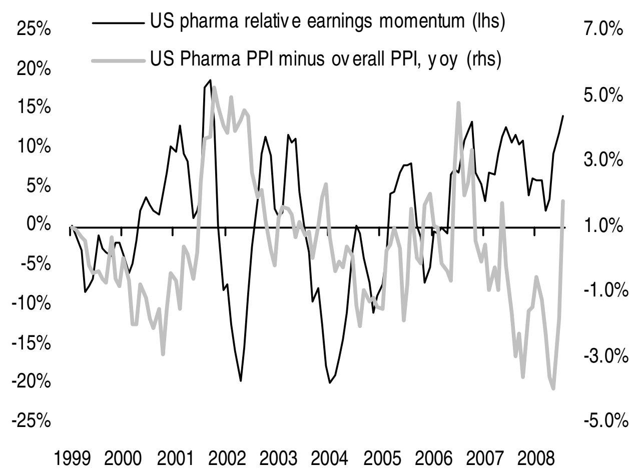
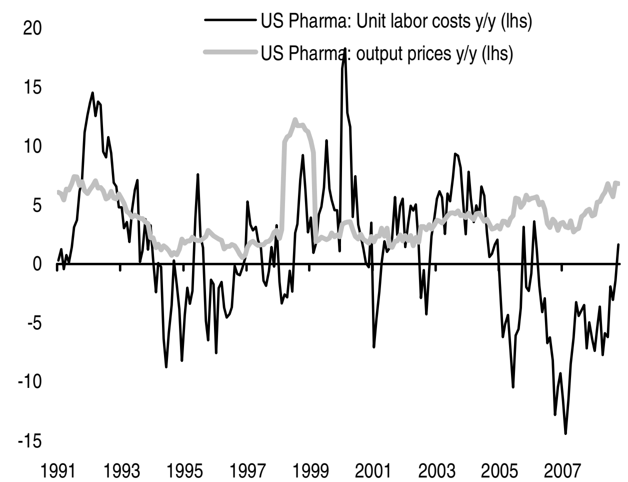
(f) It appears that margins are holding up well, with unit labour costs rising 1.7% and output prices still rising a solid 6.9% y/y. Productivity in the sector seems to be rising in the US: drug industrial output is falling 0.3% y/y, but payrolls are falling even faster at 0.9%.

Figure 250: US Pharma relative PPI and earnings momentum



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

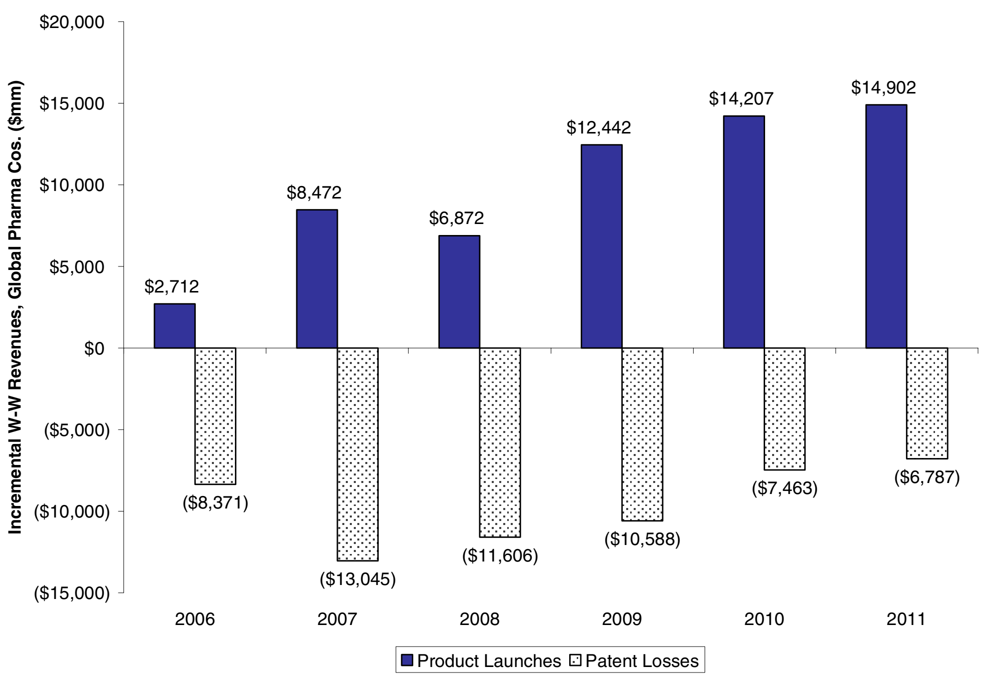
Figure 251: US Pharma margin is holding up



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Based on Credit Suisse's US pharma team's estimates, incremental revenues from product launches should begin to exceed losses from patent expiries in 2009.

Figure 252: Incremental revenues due to product launches versus patent expiries



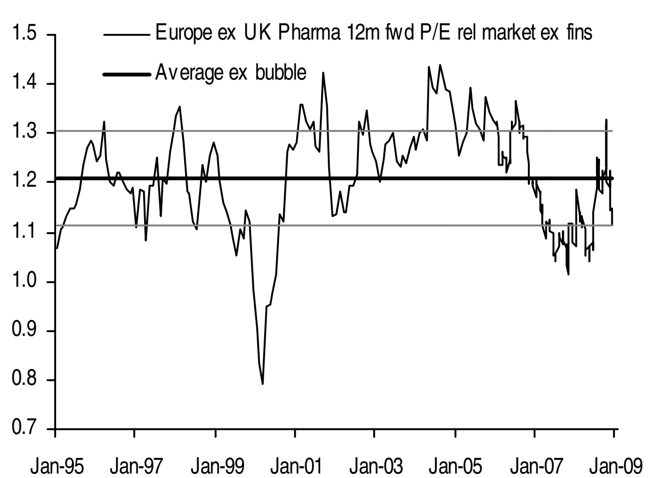
Source: US Pharma team research, Company data, Credit Suisse . forecasts from 2008 onwards.

Credit Suisse's US pharma team believes that product launches will increase modestly in the new administration with a new FDA head in place. (Of course that view could change depending on the choice of new commissioner.) The FDA is in the process of staffing up and in time the FDA should gain greater comfort on safety surveillance, which will help with the approval process.

What are the negatives?

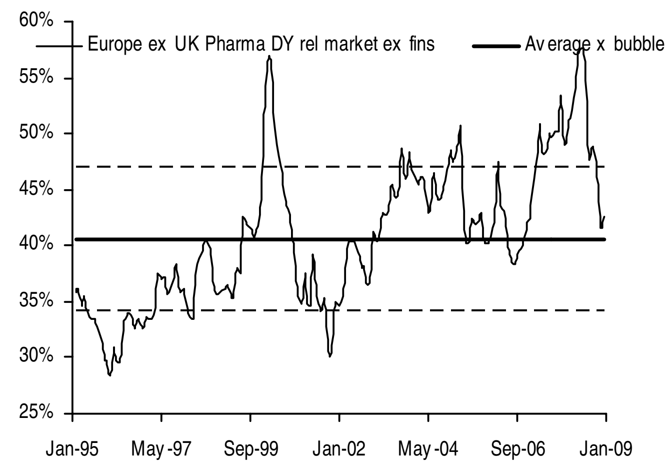
The European drugs sector looks slightly less attractive on HOLT, P/E relatives and P/B relatives than those in the US and UK, hence our preference for those countries.

Figure 253: Europe ex UK drugs 12-month forward P/E relative to market ex financials—looks more reasonable



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 254: Europe ex UK drugs DY relative to market ex financials—does not look attractive



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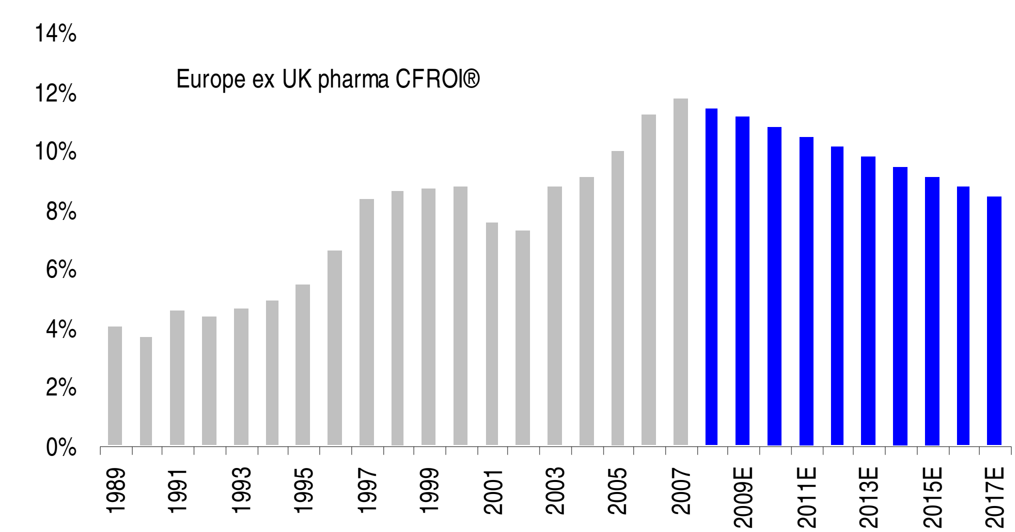
European drug companies appear to be discounting much higher levels of profitability (although the comparison may be unfair since in the early 1990s many of the drug companies had businesses in the lower-margin chemical businesses).

Figure 255: Europe (ex UK) pharma does not look too attractive on HOLT



Source: Credit Suisse HOLT, Credit Suisse research

Figure 256: **European (ex UK) pharma on HOLT: Model inputs and outputs**

Sector name	CFROI		Implied CFROI fade (percentage points)	Model inputs			Historical average (15 years)	
	2008E	Required FY10		Length of fade (y)	Assumed RAGR	Real cost of capital	CFROI	RAGR
Europe (ex UK) pharma	11.5%	8.5%	-3.0%	10	3.0%	6.0%	8.1%	4.6%

Source: Credit Suisse HOLT, Credit Suisse research

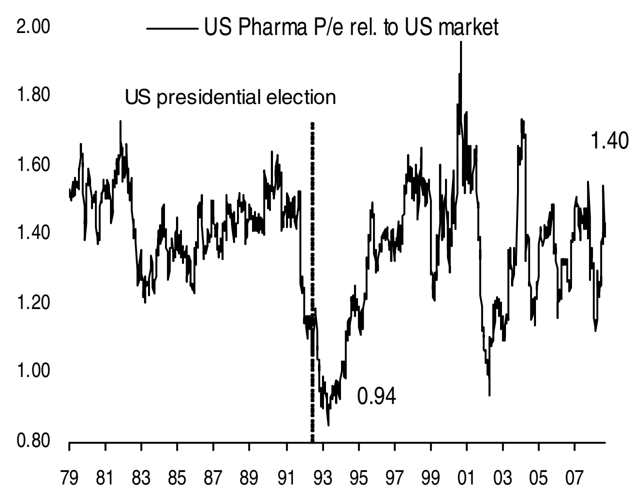
We would also highlight that the pricing environment in Europe is more challenging, with the PPI for pharmaceuticals falling 0.7% yoy (against a PPI for the overall economy rising at 6.3% y/y).

We are also worried about the impact President-elect Obama's administration may have. Nine months after the 1992 election President Clinton's attempt at healthcare reforms led to drug stocks de-rating sharply.

Figure 257: **US Pharma price relative**

Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 258: **US Pharma P/E relative**



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We are still concerned that, in a time of sharply escalating government debt, healthcare could be a relatively easy 'victim'. Branded drug prices in the US are some 20–25% above those in Europe and if branded drug prices in the US fell to European levels then the profits of the drug companies could be severely impaired. The issue is that the US government now has a very strong incentive to lower drug prices as it funds around 45% of healthcare spend and has a sharply rising budget deficit with drugs now accounting for 10% of total healthcare costs (versus 4% in 1992). Our US drugs team has already factored in conservative pricing in its assessment of the value of product launches.

The US pharma sector looks considerably cheaper on HOLT and P/E relatives.

Figure 259: US pharma looks attractive on HOLT (assuming 5% real asset growth and a ten-year fade horizon)

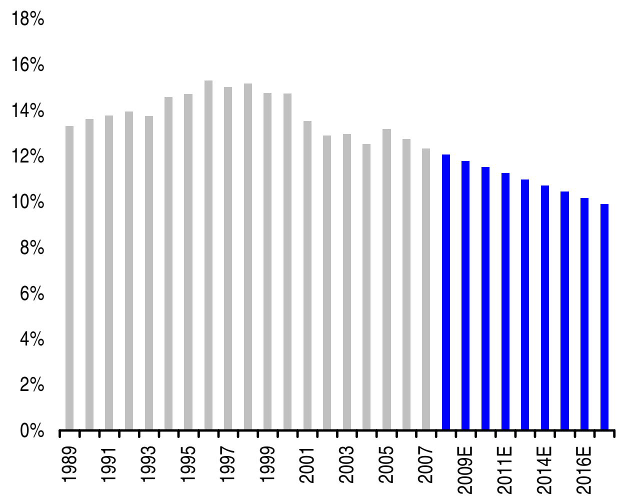

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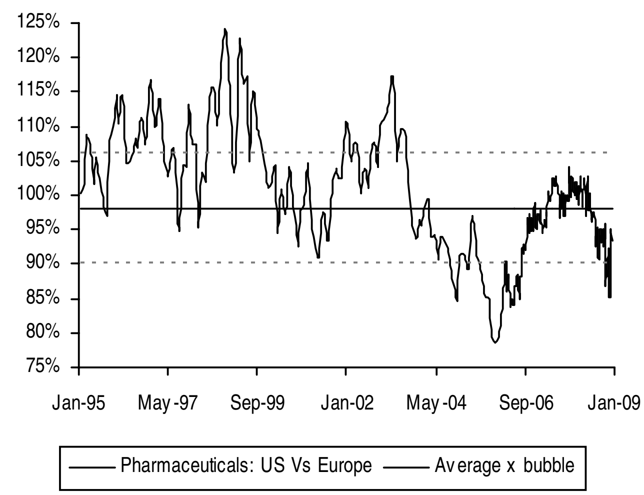
Figure 260: US pharma 12-mth fwd P/E relative to Pan Europe pharma



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Credit Suisse's US pharma team's top pick is Schering-Plough (with a 2008E FCF yield of 15%). The team's other Outperform-rated stock is Wyeth (9% FCF yield).

Figure 261: US pharma stocks with a high FCF yield (> 5%), that look cheap on HOLT

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Bristol-Myers Squibb Co	10.1	99%	-4%	3.1	-21%	5.8%	5.8%	-0.5	6.7	7.0	1.4	0.1	2.0	-0.1	1.5	-6.7	9.5	Restricted
Merck & Co	8.1	78%	-24%	2.8	-41%	10.2%	5.8%	-5.9	40.5	7.0	-0.2	-0.1	0.0	-1.3	0.0	-17.7	8.0	Neutral
Pfizer Inc	6.6	64%	-41%	1.7	-52%	13.5%	7.8%	-6.1	25.1	7.0	-1.3	0.1	0.4	-0.1	1.0	0.0	8.0	Neutral
Wyeth	9.2	90%	-3%	2.3	-45%	9.3%	3.3%	-4.1	28.3	6.0	-1.1	0.0	0.3	-0.4	0.5	-12.5	7.5	Outperform
Schering-Plough	9.4	92%	-31%	3.0	-35%	7.9%	1.8%	-1.6	51.8	6.0	3.1	0.0	4.9	-0.3	1.0	25.0	7.0	Outperform
Johnson & Johnson	12.4	120%	10%	3.5	-7%	7.6%	3.2%	-7.5	20.7	4.0	-2.5	0.0	0.5	-0.5	0.5	26.3	4.5	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Figure 262 shows a screen of the European stocks that have a 2008E FCF above 5% and look cheap on HOLT: Astrazeneca screens very well as it has all year.

Figure 262: Europe pharma stocks with a high FCF yield (> 5%), that look cheap on HOLT

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Astrazeneca	7.5	73%	-32%	3.8	2%	12.7%	5.2%	-5.6	50.0	6.0	1.8	3.1	4.7	1.2	2.0	-37.5	9.0	NR
Recordati	7.6	74%	n/a	2.0	n/a	15.0%	6.3%	-0.2	4.3	7.0	0.7	0.8	1.0	0.0	1.5	80.0	8.5	NR
Laboratorios Almir	7.7	75%	n/a	2.1	n/a	12.5%	4.9%	-0.3	8.8	7.0	0.1	-0.3	-2.2	0.4	1.0	42.9	8.0	NR
Sanofi-Aventis	7.9	77%	-27%	1.4	-6%	10.5%	4.7%	-5.9	31.0	7.0	-2.2	-1.7	-1.8	0.1	0.5	6.7	7.5	NR
Merck Kgaa	9.7	94%	-5%	1.5	-22%	9.7%	2.2%	-0.9	20.0	6.0	1.5	-0.3	1.7	0.4	1.5	44.0	7.5	NR
H.Lundbeck A/S	9.1	89%	-26%	3.0	-10%	8.9%	2.5%	-4.0	21.6	6.0	0.1	-0.5	-4.2	-0.5	0.5	-50.0	7.5	Neutral
Novartis Ag	11.0	107%	-3%	2.0	-12%	7.6%	3.7%	-5.7	47.7	5.0	1.2	2.3	10.9	13.4	2.0	12.5	7.0	NR
Shire	14.5	141%	n/a	7.0	n/a	8.2%	0.7%	-7.4	67.9	4.0	6.0	-2.3	5.2	2.2	1.5	44.4	5.5	NR
Bayer Ag	10.4	101%	34%	1.8	84%	12.0%	3.6%	0.6	14.9	2.0	0.6	-0.2	-2.3	-0.2	0.5	31.4	2.5	NR

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Cyclicals: Stay underweight, though less than before!

We stay underweight cyclicals as we have done since July 2007 as cyclicals are not yet cheap enough, in our view. However, we have reduced the size of our underweight in November *("What to do with cyclicals ?",* dated 12 November 2008*).*

Worst economic outlook for 50 years:

This is the worst economic environment in the G7 since 1945. For more details please see p3–11 in our piece *2009 Outlook: Asset Allocation*, dated 9 December.

We believe it will take around two years for GDP growth to revert to trend as:

(1) There is US$5trn of excess leverage globally (US$2.5trn for US households).

Figure 263: **There is US$5tn excess leverage in the G4 countries (around 20% of GDP)**

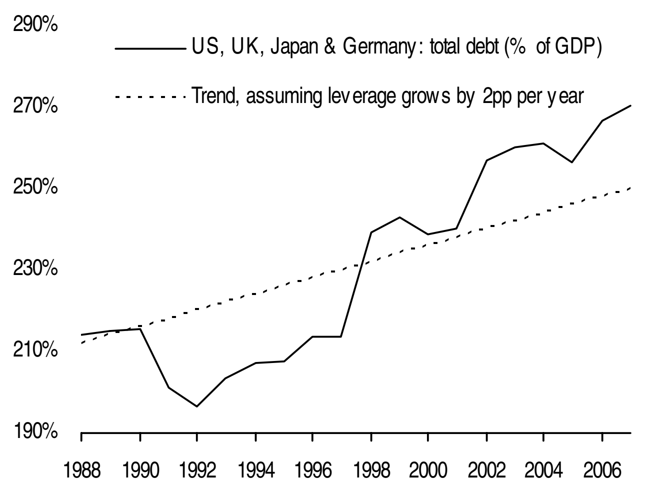

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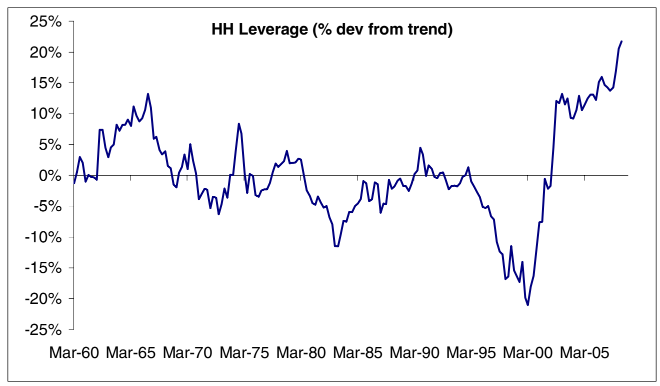
Figure 264: **US household leverage, % deviation from trend**



Source: Federal Reserve, Credit Suisse research

(2) Bank lending conditions are the tightest on record and consistent with loan growth in the US contracting by 7% over the next 12 months.

(3) There are still 1.7m excess inventories of US homes.

(4) Housing looks overvalued almost everywhere (excluding Germany and the US).

Valuation not that cheap

Despite this being the worst economic outlook for 50 years, cyclicals are not particularly cheap if we look at the forward P/E or P/B relatives to the market.

Figure 265: European cyclicals P/B relative to the market

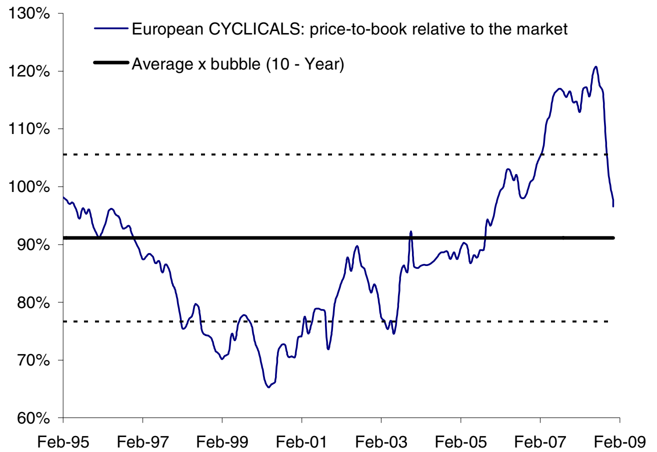


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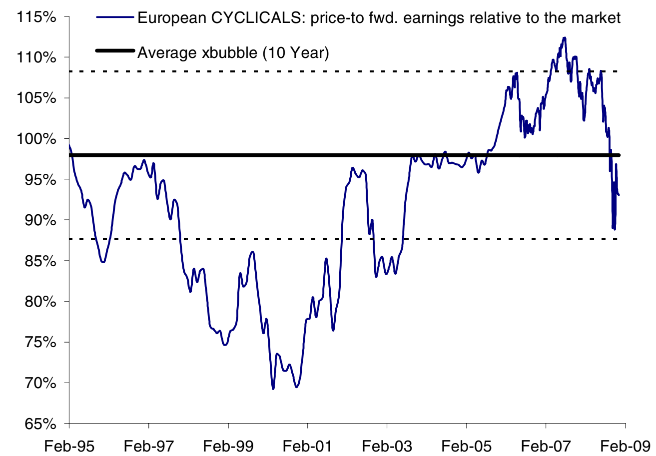
Figure 266: European cyclicals 12-mth fwd P/E relative to the market



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The valuation of cyclicals relative to defensives (Figure 267 and Figure 268) are not yet at all-time lows—surely they should be given the macro environment?!

In order to return to all-time P/B lows, cyclicals would have to underperform defensives by a further 46%. The P/E relatives may be close to an all-time low but we believe the earnings of cyclicals could be revised down 20% or more relative to those of defensives (we show the US P/B and P/E relatives to defensives in Appendix 9).

Figure 267: European cyclicals P/B relative to defensives

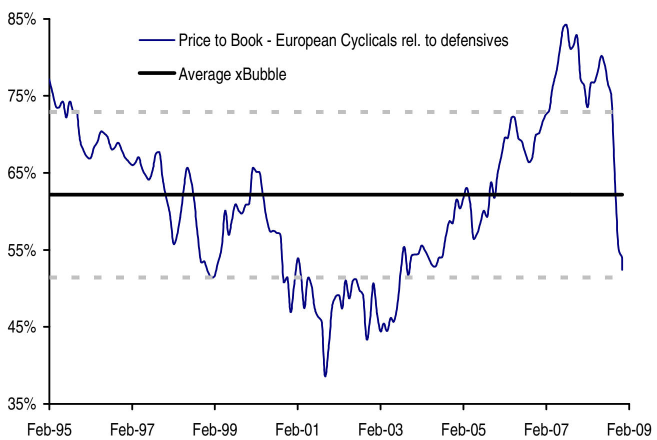

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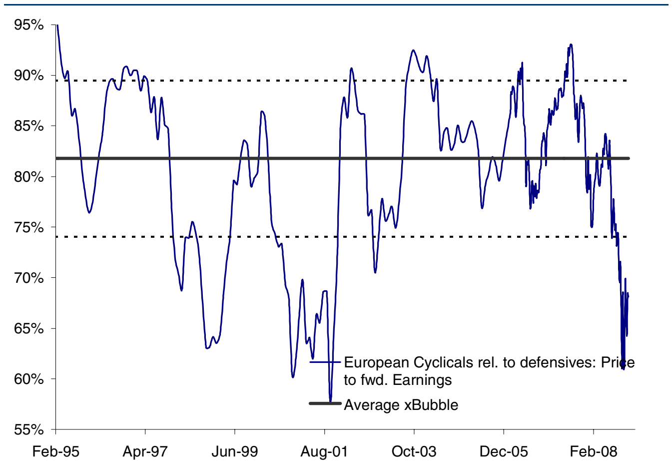
Figure 268: European cyclicals 12m forward P/E relative to defensives



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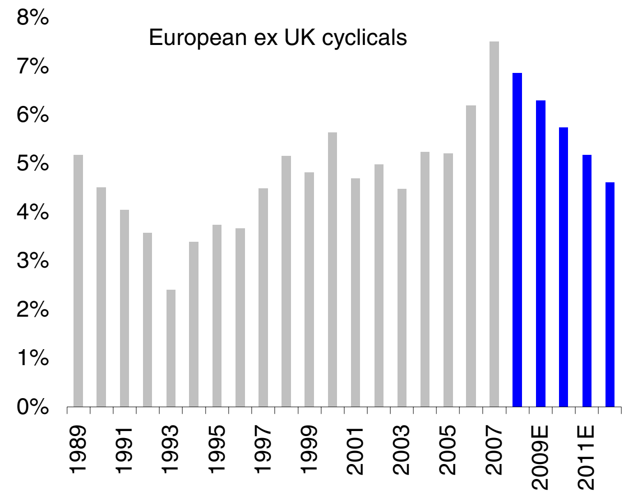
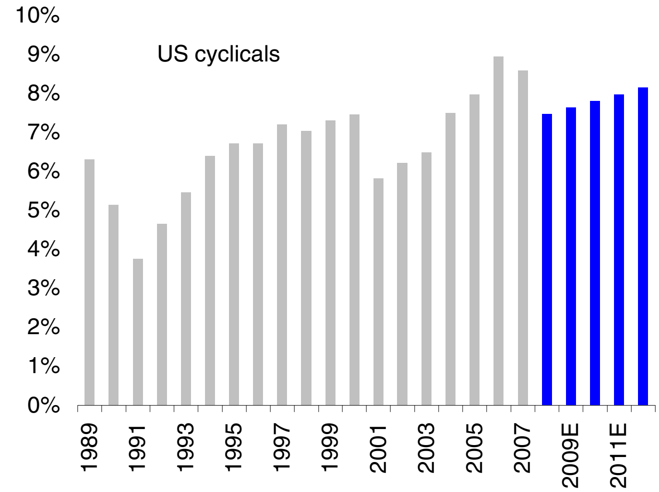
Moreover, on HOLT cyclicals are beginning to discount below-average levels of profitability in Europe but hardly super-depressed levels. In the US, cyclicals still look to be discounting demanding levels of profitability (if we look for the profitability required to make the sector fair value relative to the market).

Figure 269: **European cyclicals on HOLT**



Source: Credit Suisse HOLT, Credit Suisse research

Figure 270: **US cyclicals on HOLT**



Source: Credit Suisse HOLT, Credit Suisse research

Figure 271: **HOLT valuation for cyclicals: Model inputs**

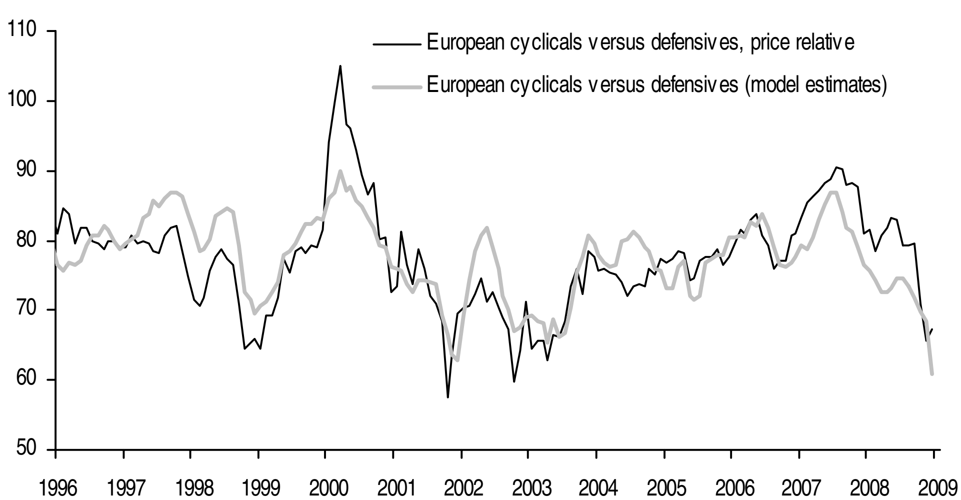
	CFROI®			Model inputs (assumptions)		15 year average	
Sector name	2008E	Required FY5	Implied CFROI® fade	Length of fade (y)	Real asset growth rate	CFROI®	Real asset growth
Europe ex UK cyclicals	6.9%	4.6%	-2.2%	5	2.8%	4.8%	3.8%
US cyclicals	7.5%	8.2%	0.7%	5	3.6%	7.1%	4.0%
UK cyclicals	11.6%	7.2%	-4.4%	5	2.8%	8.2%	4.9%

Source: Credit Suisse HOLT, Credit Suisse research. Sectors included: Capital Goods, Automobiles & Components, Commercial Services, Consumer Durables, Consumer Services, Materials, Retailing, Transportation

Our model implies further underperformance

Our model for cyclicals suggests they should underperform by a further 10%. The inputs into the model are: IFO, bond yields, earnings momentum and risk appetite.

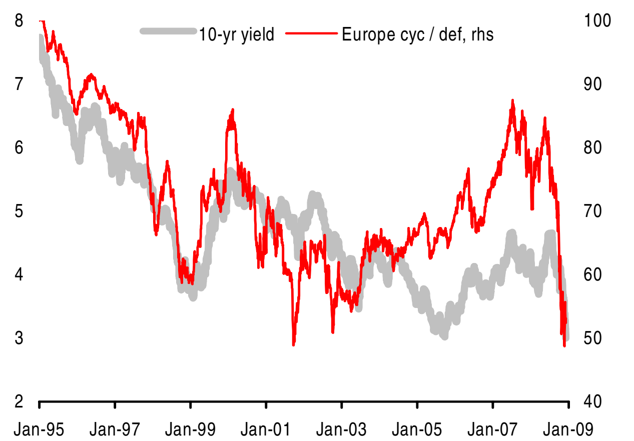
Figure 272: **European cyclicals: Price performance (relative to defensives) versus model estimates**



Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

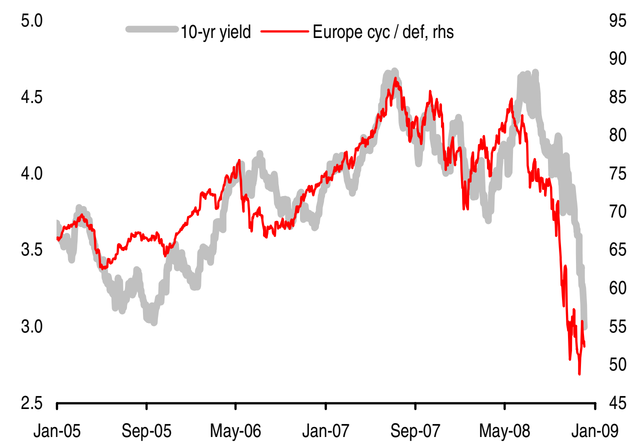
We believe that the time to buy cyclicals is when bonds yields are on the rise. 70% of the time bond yields rise, cyclicals outperform defensives. We would not expect bond yields to rise significantly for the next 3–6 months, given weak growth, falling inflation and monetary easing.

Figure 273: Cyclicals relative to defensives versus bond yields



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 274: Cyclicals relative to defensives versus bond yields



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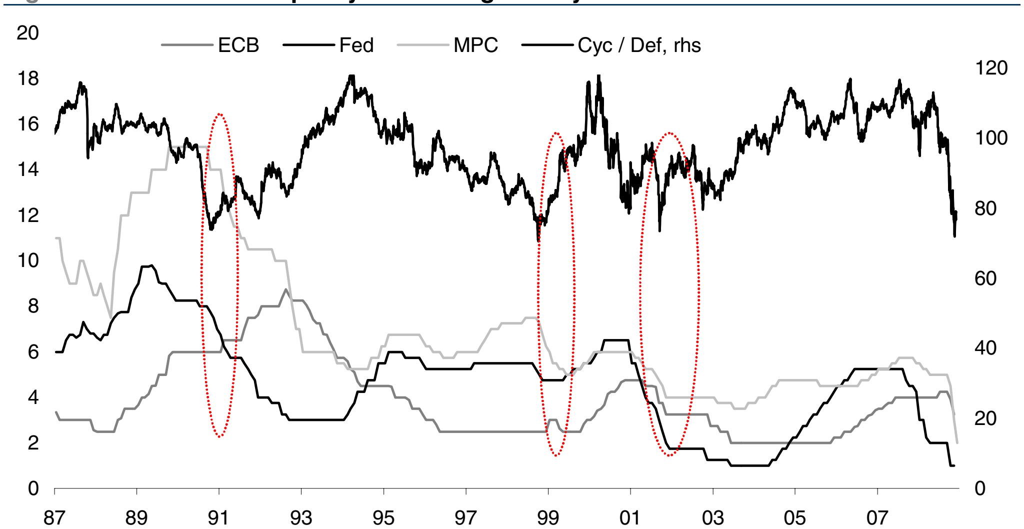
Time to buy cyclicals in Europe is typically up to seven months after the ECB cuts rates

Historically, cyclicals start outperforming up to seven months after the ECB has joined the Fed in cutting rates. Again this would imply later in Q1 09. However, this is what usually happens into a 'normal' cycle and this cycle is anything but normal.

Figure 275: Central bank policy rates and global cyclical relative to defensives



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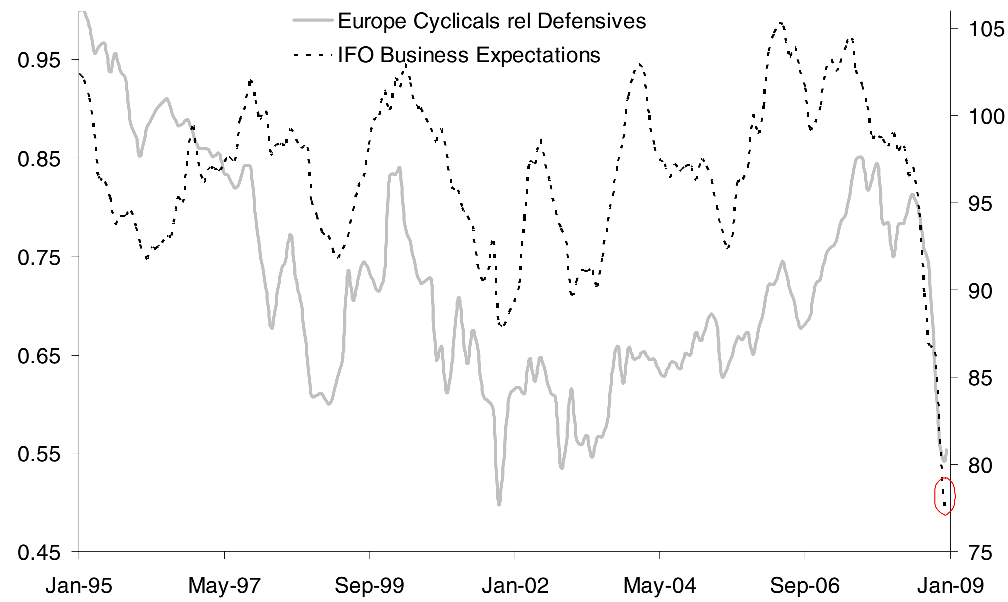
We would also highlight that normally the time to buy cyclicals is around two months before the trough in IFO, as shown below.

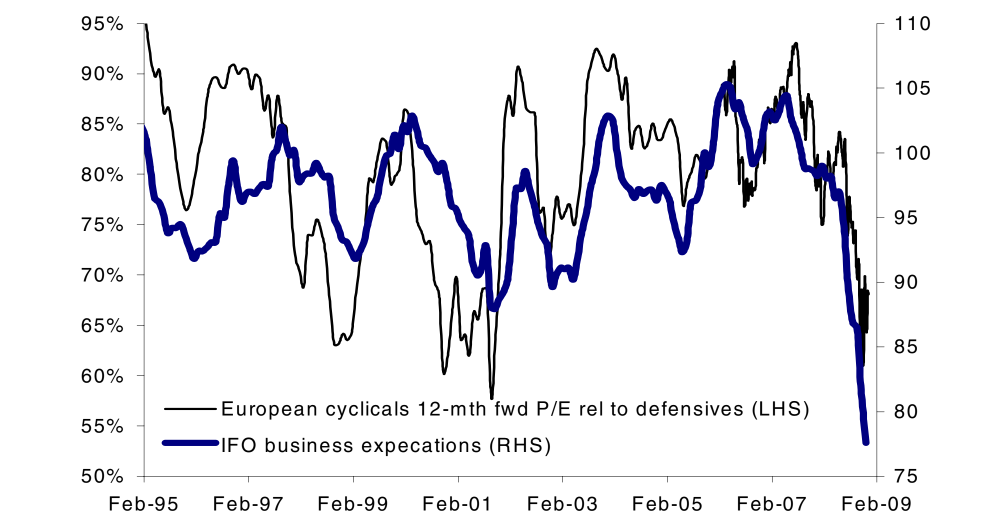
Figure 276: **European cyclicals relative to defensives versus IFO business expectations**



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Perhaps there should have been more of a de-rating of cyclicals given the collapse in IFO business expectations.

Figure 277: **European cyclicals relative to defensives versus IFO business expectations**



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While we think IFO is close to a trough, we are concerned that the de-stocking process could be even more aggressive given where inventories are and thus IFO could trough in late Q1!

The four key catalysts that we watch in order to determine whether the economy has stopped deteriorating and to go overweight cyclicals are:

(1) Inventory positions

Inventories are now at record levels relative to orders and sales across the globe, which implies even weaker output in the quarters ahead.

Figure 278: **PMI inventory to orders ratio (x)**

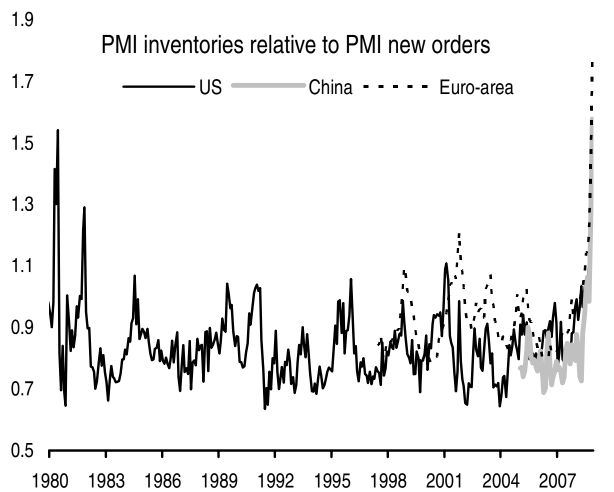

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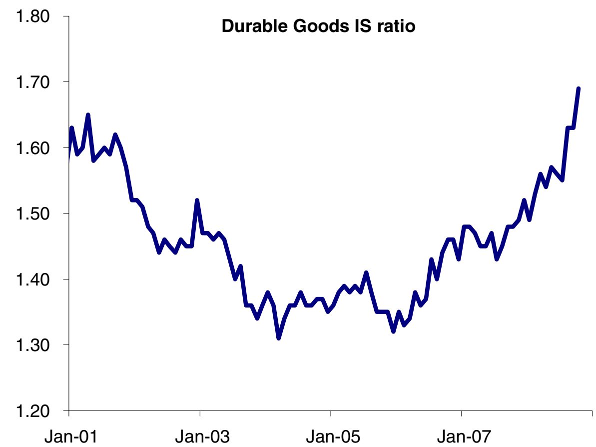
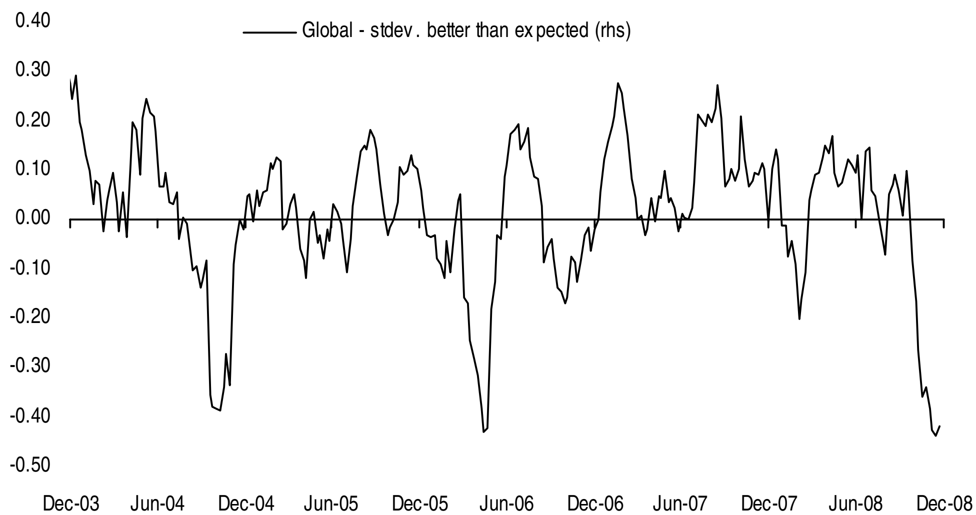
Figure 279: **US durable goods inventory to shipment ratio (x)**



Source: US Census, Credit Suisse research

(2) Lead indicators. The Westpac economic surprise indicator has to bottom out.

Figure 280: **Westpac index (of macro-economic surprises) is collapsing—can it get any worse?**



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse research

(3) US housing. This has been the epicentre of the credit crisis. The good news is that affordability is now at a 30-year high (and 38% above average) but there is still 1.7m of excess housing inventory. We want to see these inventories peak and see signs that permits are turning. We think inventories will peak at the end of Q1.

Figure 281: **US housing affordability index at a 30-year high**

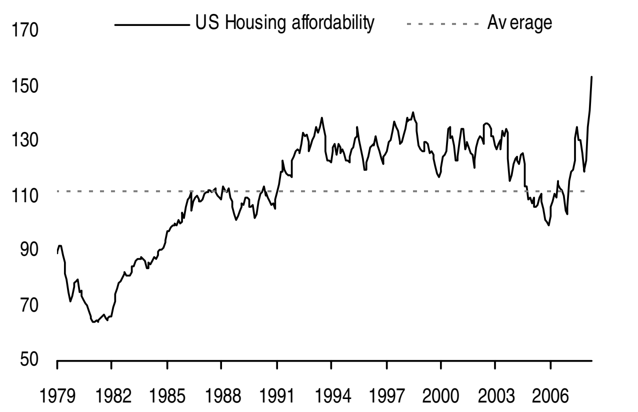


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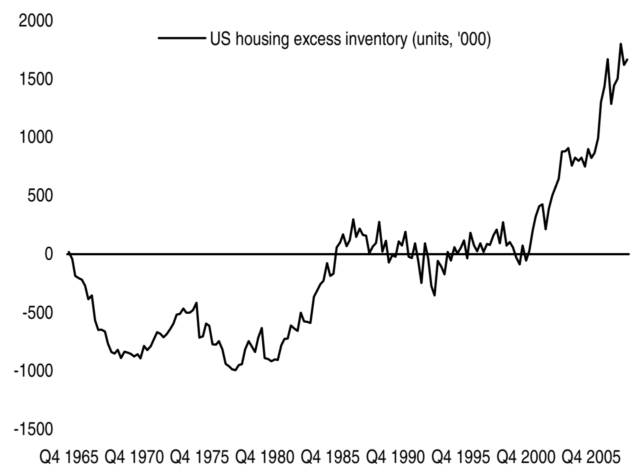
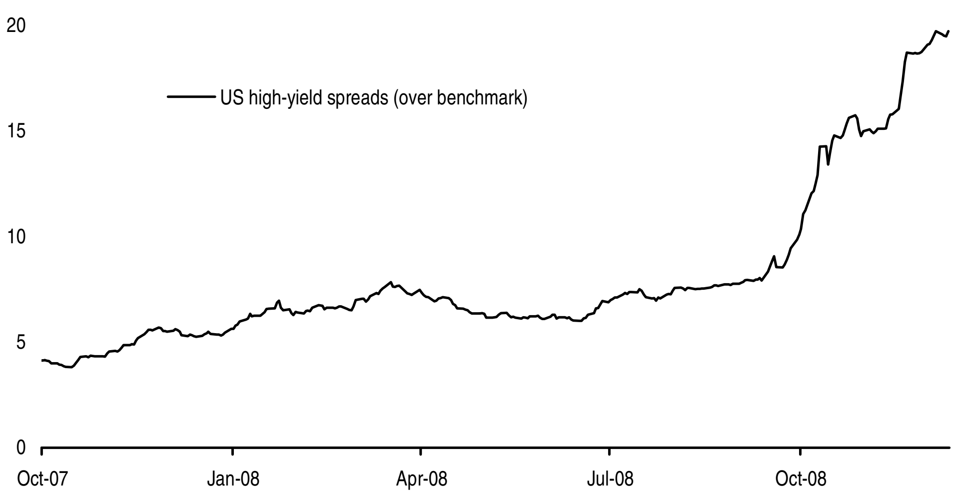
Figure 282: **US housing excess inventory**



Source: © Datastream International Limited ALL RIGHTS RESERVED, Congressional Budget Office, Credit Suisse research

(4) Credit markets opening up. The high yield spread not only has to fall but there have to be clear signs that corporates are able to issue debt.

Figure 283: **US corporate speculative debt: Spreads over benchmark**



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(5) Easing of bank lending conditions.

We would rather be late calling the trough and see some confirmation of the events above happening.

Consensus earnings estimates look far too optimistic:

We believe consensus 2009 revenue and margin estimates for European cyclicals are still too high (Figure 286).

Figure 284: **European cyclicals sectors' consensus sales growth**

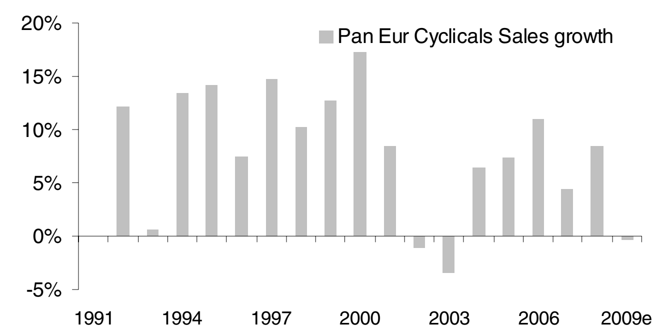

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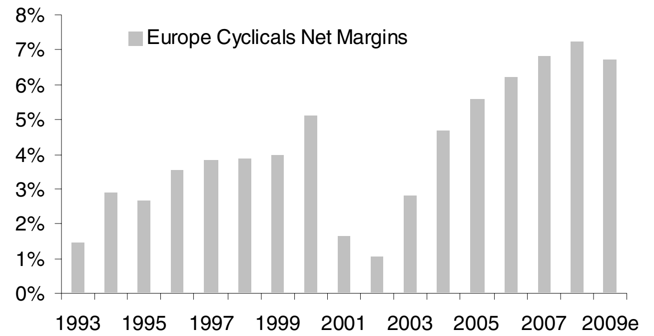
Figure 285: **European cyclicals sectors' consensus net income margins**



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We show the charts for the US cyclicals in Appendix 9.

We find it surprising that consensus revenue estimates have only fallen 6% for European cyclicals over the past six months and in some sectors (media and commercial services) revenue estimates for 2009 have even been revised up.

Figure 286: **Cyclicals: Sales and EPS growth consensus estimates**

Pan Europe sectors	**2009e sales growth**		**Change in 2009e sales last 6m**	**2009e EPS growth**		**Change in 2009e EPS last 6m**
	Now	**Change in last 6m**		**Now**	**Change in last 6m**	
Automobiles & Components	-5.3%	-12.0%	-12.0%	-34.8%	-49.0%	-59.7%
Capital Goods	-1.3%	-7.2%	-7.2%	6.1%	-8.1%	-21.7%
Commercial & Professional Services	4.6%	11.5%	11.5%	-1.7%	-11.5%	-16.6%
Consumer Durables & Apparel	3.4%	-0.6%	-0.6%	-1.2%	-12.0%	-24.2%
Consumer Services	1.3%	-4.9%	-4.9%	2.2%	-10.0%	-27.3%
Materials	-6.5%	-8.1%	-8.1%	-17.6%	-31.7%	-25.2%
Media	5.2%	2.1%	2.1%	6.7%	-5.9%	-15.2%
Retailing	8.6%	-5.3%	-5.3%	-4.6%	-14.4%	-34.7%
Semiconductors & Semiconductor Equipment	-10.9%	-16.1%	-16.1%	-50.0%	-50.0%	-78.6%
Software & Services	3.1%	-3.4%	-3.4%	4.1%	-10.4%	-16.2%
Technology Hardware & Equipment	-1.2%	-3.6%	-3.6%	6.5%	-3.4%	-12.0%
Transportation	2.0%	-2.0%	-2.0%	-4.6%	-16.6%	-33.9%
Cyclicals	**-0.3%**	**-5.7%**	**-6.0%**	**-9.5%**	**-23.0%**	**-31.9%**
Market	**-0.4%**	**-4.0%**	**-4.0%**	**2.9%**	**-10.3%**	**-23.4%**
Market ex financials	**-1.8%**	**-3.6%**	**-3.6%**	**-3.9%**	**-15.0%**	**-17.6%**
Market ex financials ex resources	**2.4%**	**-3.0%**	**-2.3%**	**3.4%**	**-9.6%**	**-16.1%**

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Factset, Credit Suisse research

Hence, if we normalise margins, we can see that the P/Es do not look so cheap! (Figure 287 and Figure 288).

Figure 287: European cyclicals' 12-mth fwd P/E versus net income margins—if we normalise margins the P/E is 16.6

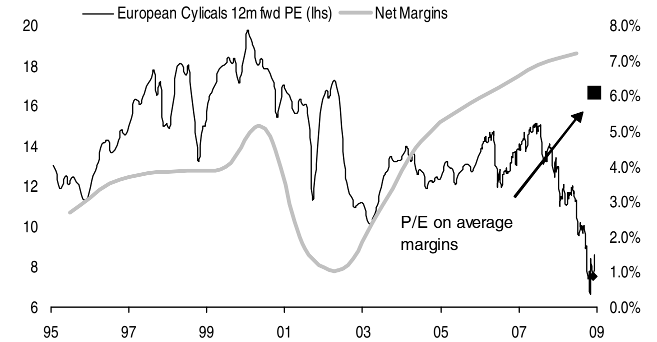

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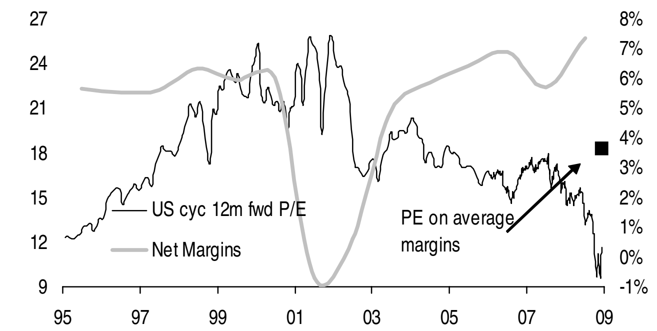
Figure 288: US cyclicals' 12-mth fwd P/E versus net income margins—if we normalise margins the P/E is 18.3



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We can see that relative earnings momentum has started to deteriorate sharply and lead indicators clearly suggest that they will get worse (Figure 289 and Figure 290).

Figure 289: European cyclicals rel Defensives: Earnings momentum versus ISM

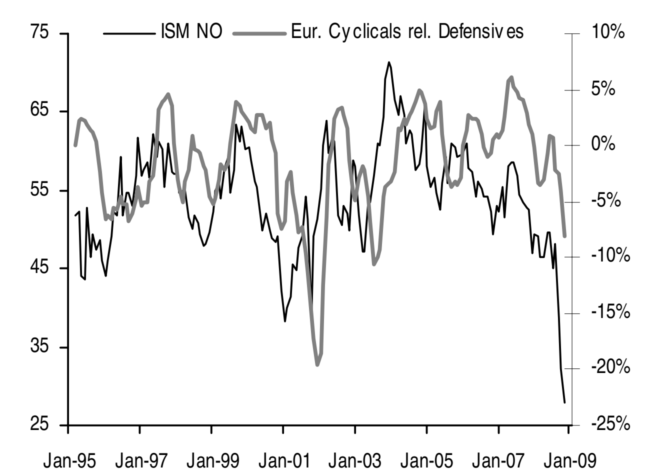

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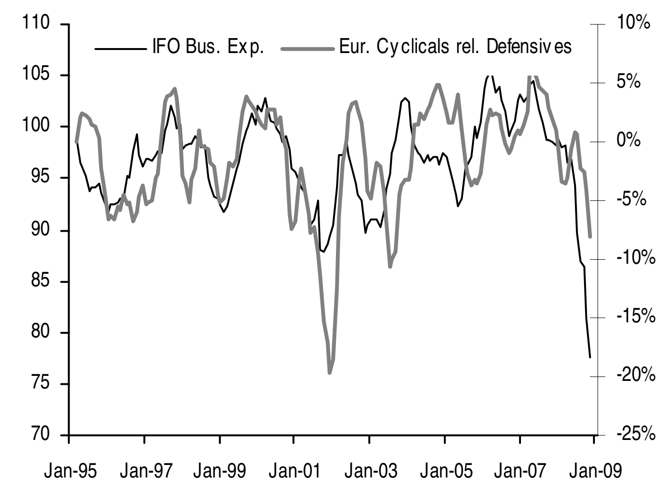
Figure 290: European cyclicals rel Defensives: Earnings momentum versus IFO



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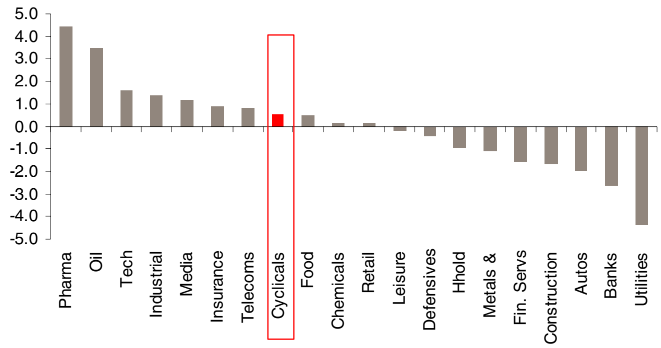
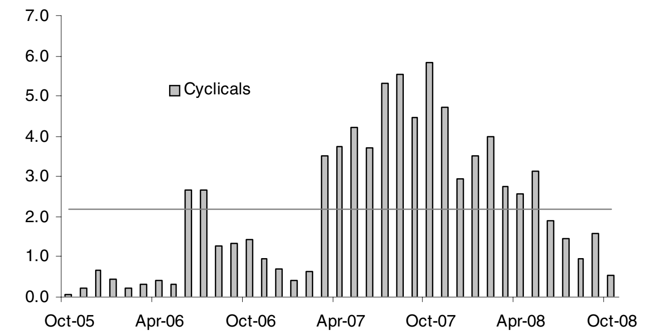
Investors are still slightly overweight cyclicals . . .

Figure 291: **Investors are still overweight cyclicals (ex mining) on our Frank Russell index . . .**



Source: Frank Russell, Credit Suisse research

Figure 292: **. . . but less so than they have been over the past year**



Source: Frank Russell, Credit Suisse research

We are far less underweight than we were three or six months ago as valuations are cheaper, policy is proactive and we believe we are within a quarter of the trough in lead indicators.

To go overweight cyclicals, we need to:

a) see lead indicators turn decisively;

b) believe that bonds yields are going to rise; and

c) see valuations getting close to all-time lows on P/B relatives.

We are closer to all these events than we were 12 months ago but still not there!

We rank cyclicals sectors on the following criteria:

(i) Valuation: P/B relative to market (expressed as the number of standard deviations above/below long-term average), EV/Sales, VCR;

(ii) Degree of cyclicality: correlation with OECD lead indicators;

(iii) Revenues: 2008 and 2009 estimates relative to long-term averages (expressed as the number of standard deviations above/below long-term average);

(iv) Margins: 2008 estimates relative to long-term averages (expressed as the number of standard deviations above/below long-term average);

(v) Leverage: net debt as a percentage of market cap; and

(vi) Earnings momentum: three-month earnings upgrades minus earnings downgrades as a percentage of total earning estimates.

Figure 293: European cyclical: Overall risk scorecard (sectors at the top are the least cyclical)

Pan Eur Sector	Valuation	Cyclicality	Revenues	Margins	Leverage	Earnings Momentum	Overall Rank
Software	2	-0.10	0.17	1.17	-4.0%	-16.3%	1
Commercial Services	4	0.04	0.32	-0.06	19.5%	-5.8%	2
Technology Hardware	3	0.19	0.34	0.54	-8.9%	-21.2%	3
Media	7	0.08	0.06	0.99	43.6%	-16.4%	4
Semiconductors	1	0.40	0.27	-1.13	2.3%	-37.9%	5
Metals and Mining	5	0.29	-1.97	1.63	17.6%	-30.4%	6
Hotels & Leisure	12	0.27	0.11	1.28	21.0%	-12.2%	7
Chemicals	11	-0.04	0.02	2.58	25.8%	-19.0%	8
Retailing	8	0.24	0.05	6.09	18.3%	-25.7%	9
Automobiles	6	0.19	0.15	1.63	40.0%	-31.3%	10
Transport	10	0.42	0.40	0.71	52.5%	-11.8%	11
Capital Goods	13	0.58	-0.29	1.71	42.1%	-18.2%	12
Construction Materials	9	0.48	0.13	1.84	90.4%	-22.4%	13

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Figure 294 shows details of the valuations scorecard for European cyclicals.

Figure 294: European cyclicals: Valuations scorecard

Europe	P/B		EV/Sales		VCR		
Sector	Current	rel to market SDs above/ below average	Current	SDs above/ below average	Current	SDs above/ below average	Overall Rank
Semiconductors	1.0	-0.8	1.4	-1.2	50%	-1.3	1
Software	2.5	-0.1	2.3	-1.2	190%	-1.1	2
Technology Hardware	2.1	-0.5	0.9	-0.9	93%	-1.1	3
Commercial Services	3.0	0.8	0.7	-1.5	185%	-0.7	4
Metals & Mining	1.0	-0.9	0.6	-1.3	86%	0.0	5
Automobiles	0.9	0.9	0.4	-1.1	71%	-0.8	6
Media	2.0	1.0	1.3	-1.0	168%	-0.9	7
Retailing	1.9	0.8	1.4	0.8	132%	-1.2	8
Construction Materials	1.0	-0.3	1.1	-0.5	93%	-0.4	9
Transportation	1.4	0.6	0.9	-0.6	92%	-0.2	10
Chemicals	1.5	1.2	0.8	-0.8	84%	-0.4	11
Hotels & Leisure	2.3	2.5	1.1	-0.9	112%	-0.4	12
Capital Goods	1.6	0.8	1.0	-0.1	109%	-0.2	13

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Factset, Credit Suisse HOLT, Credit Suisse research

We show the scorecards for the US in Appendix 10.

Figure 295 and Figure 296 show the cyclical stocks that trade on more than a 20% premium to their norm on P/B and are more than 20% expensive on HOLT:

Figure 295: European cyclicals with P/B relative more than 20% above norm and more than 20% expensive on HOLT

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Sodexo	15.2	127%	28%	3.1	60%	4.8%	3.0%	3.0	-75.4	0.0	1.5	0.0	-0.1	-0.3	0.5	6.7	0.5	Neutral
Air Liquide(L')	13.1	149%	25%	2.7	64%	4.4%	3.5%	4.3	-39.4	0.0	0.0	0.0	-1.0	-0.3	0.0	-10.3	1.0	Neutral
Hermes Intl	36.6	321%	139%	7.6	109%	2.1%	1.0%	20.0	-72.0	0.0	-0.2	-3.1	-5.1	0.0	0.0	-100.0	1.0	Underperform
Acerinox Sa	17.7	333%	169%	1.5	62%	0.5%	3.4%	1.4	-34.2	0.0	-6.7	-27.8	-53.8	-12.9	0.0	-56.5	1.0	Underperform
Eutelsat Communica	17.4	163%	29%	2.9	83%	3.0%	3.6%	6.9	-84.3	1.0	-1.3	0.0	0.0	0.0	0.0	53.9	1.0	NR
Capita Group	18.7	n/a	32%	14.0	176%	4.3%	2.0%	4.2	-43.1	0.0	5.3	0.1	0.0	0.3	1.5	6.7	1.5	NR
Volkswagen Ag	35.2	130%	385%	3.4	345%	4.1%	0.6%	7.7	-65.5	0.0	0.4	-0.1	-2.8	0.5	1.0	-100.0	2.0	Underperform
Serco Group	15.7	132%	24%	4.0	37%	6.7%	1.2%	11.7	-71.9	1.0	1.9	0.1	0.0	0.0	1.0	71.4	2.0	NR
Iberia Lineas Aere	46.6	272%	500%	1.0	28%	7.1%	1.0%	5.0	-119.2	1.0	-1.7	-36.5	-50.3	-0.6	0.0	-20.0	2.0	NR
Novozymes A/S	21.8	248%	51%	6.9	136%	2.6%	1.3%	8.5	-54.3	0.0	-0.9	0.7	1.8	0.2	1.5	-53.9	2.5	NR
Bunzl	11.2	269%	36%	4.0	85%	9.5%	3.4%	4.6	-33.9	1.0	1.8	0.0	0.2	0.7	1.5	53.9	2.5	NR
Abertis Infraestr	13.4	88%	39%	2.2	63%	7.9%	4.5%	1.2	-24.8	2.0	0.3	-1.2	-4.1	-0.9	0.5	25.9	2.5	Underperform
Cobham	10.9	130%	36%	2.7	56%	7.5%	2.7%	4.5	-36.3	1.0	3.2	0.1	0.9	1.6	2.0	11.1	3.0	Neutral
Acs Actividades Co	9.7	102%	51%	2.4	34%	5.0%	6.6%	5.4	-60.0	2.0	-0.2	-5.5	-5.8	-0.9	0.0	-23.8	3.0	Underperform
Ubisoft Entertain	15.9	144%	-2%	2.7	141%	36.0%	0.0%	1.4	-28.7	2.0	-9.0	-2.6	-0.4	-0.2	0.0	-7.7	3.0	NR
Compass Group	13.1	110%	39%	3.1	49%	6.7%	3.8%	17.1	-58.7	2.0	5.2	-0.2	0.5	0.4	1.5	36.4	3.5	Neutral
Fielmann Ag	15.0	114%	29%	3.9	108%	5.9%	4.5%	9.0	-49.0	2.0	2.6	2.6	3.7	0.0	1.5	56.5	3.5	NR
Alstom	10.2	95%	27%	5.8	226%	7.7%	2.6%	15.1	-35.9	2.0	10.8	0.2	-1.2	-0.5	1.0	-36.4	4.0	Neutral
Neopost	12.7	116%	24%	4.6	65%	8.8%	6.0%	3.8	-31.7	2.0	0.8	0.3	1.1	0.3	2.0	28.6	4.0	NR
Zardoya-Otis	22.5	264%	70%	20.3	103%	3.9%	4.4%	-7.0	-60.4	2.0	-17.7	0.7	0.1	0.6	1.5	-69.2	4.5	NR
Bic	13.2	111%	38%	1.8	22%	7.4%	3.2%	3.1	-29.7	2.0	-1.6	0.1	2.8	1.8	1.5	-81.8	4.5	NR
Electrolux Ab	9.4	65%	23%	1.5	45%	7.3%	5.0%	0.6	-31.9	3.0	-1.8	-0.3	-4.3	1.7	0.5	-56.5	4.5	NR
Autoroutes Paris-R	14.8	97%	-15%	60.4	1839%	4.3%	6.4%	4.7	-57.0	3.0	0.7	NM	NM	NM	2.0	n/a	5.0	NR

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Factset, Credit Suisse HOLT, Credit Suisse research

Figure 296: US cyclicals with P/B relative more than 20% above norm and more than 20% expensive on HOLT

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Marriott Intl Inc	12.5	104%	9%	4.2	101%	1.0%	2.0%	3.9	-46.1	0.0	-0.7	-1.8	-9.4	-1.8	0.0	0.0	0.0	NR
Praxair Inc	13.0	147%	33%	4.4	82%	3.6%	2.7%	4.8	-38.0	0.0	1.4	-0.4	-1.6	-1.0	0.5	22.2	0.5	Neutral
Hunt (Jb) Transprt Svcs Inc	14.9	132%	46%	6.5	178%	0.9%	1.2%	5.0	-49.4	0.0	1.5	-0.8	0.5	-1.7	1.0	44.4	1.0	Neutral
Mcdonald'S Corp	15.6	130%	57%	5.1	136%	4.8%	2.8%	7.8	-51.4	0.0	2.9	0.1	2.3	-0.6	1.5	22.2	1.5	Neutral
Fastenal Co	19.3	464%	7%	4.7	21%	4.8%	1.8%	4.9	-46.4	0.0	1.3	-1.1	-0.9	-1.5	0.5	-60.0	1.5	NR
Martin Marietta Materials	22.2	229%	140%	3.7	43%	1.1%	1.5%	6.5	-64.1	0.0	-2.4	0.8	-12.1	-2.9	0.5	-63.6	1.5	NR
Lockheed Martin Corp	10.1	120%	19%	3.3	97%	9.1%	2.2%	3.9	-25.7	1.0	1.8	0.0	-0.3	-0.4	0.5	20.0	1.5	Neutral
Waste Management Inc	13.2	111%	29%	2.5	41%	4.8%	3.3%	5.5	-47.9	1.0	0.0	-0.8	-0.9	-1.3	0.5	100.0	1.5	NR
Republic Services Inc	13.2	111%	31%	3.4	96%	5.7%	2.9%	8.7	-49.8	1.0	1.3	-0.3	-0.2	-0.3	0.5	100.0	1.5	NR
Pall Corp	12.9	152%	15%	2.9	54%	6.5%	n/a	5.0	-42.6	1.0	2.3	0.0	0.0	0.0	0.5	14.3	1.5	NR
Family Dollar Stores	13.5	114%	35%	2.6	25%	6.0%	1.4%	3.4	-54.0	1.0	-0.8	0.0	0.0	0.0	0.0	-46.7	2.0	Neutral
Foundry Networks Inc	21.7	183%	18%	2.1	24%	4.4%	n/a	4.2	-44.1	0.0	-0.1	0.9	1.9	0.1	1.5	-20.0	2.5	NR
United Parcel Service Inc	15.1	116%	14%	4.9	51%	4.2%	3.3%	5.6	-45.1	1.0	-1.4	0.2	-0.4	-0.7	0.5	-26.3	2.5	Neutral
Rohm And Haas Co	22.4	255%	145%	4.2	161%	5.1%	2.2%	6.2	-56.5	1.0	0.1	-2.1	-5.1	-1.7	0.5	-100.0	2.5	Neutral
Sigma-Aldrich Corp	14.7	167%	28%	3.2	51%	6.8%	1.1%	2.4	-21.3	1.0	1.4	-0.1	-2.0	-3.1	0.5	-33.3	2.5	NR
Ross Stores Inc	11.6	87%	46%	3.6	30%	4.6%	1.5%	3.0	-34.0	1.0	1.0	-1.4	-3.7	-2.0	0.5	-23.1	2.5	Neutral
Aptargroup Inc	13.7	141%	39%	1.8	43%	5.9%	1.8%	2.1	-20.6	1.0	0.5	0.0	-2.7	-2.8	0.5	-11.1	2.5	NR
Burlington Northern Santa Fe	11.3	100%	53%	2.2	59%	4.4%	1.8%	2.4	-21.1	1.0	0.8	-0.2	6.5	-1.4	1.0	-33.3	3.0	Neutral
Amr Corp/De	4.7	27%	-35%	2.9	265%	-29.3%	0.0%	4.3	-164.1	2.0	-4.9	NM	NM	0.1	1.0	14.3	3.0	NR
Raytheon Co	11.0	131%	30%	1.7	43%	7.8%	2.2%	4.2	-21.5	1.0	1.2	0.0	0.9	0.4	1.5	-11.1	3.5	Neutral
Block H & R Inc	10.8	n/a	9%	7.7	161%	8.5%	3.0%	-0.9	-30.9	3.0	0.3	-1.1	-2.6	-2.9	0.5	25.0	3.5	NR
Starwood Hotels&Resorts Wrld	12.0	100%	-21%	1.6	37%	9.4%	5.6%	2.8	-75.9	3.0	-1.6	-0.2	-5.9	-3.1	0.0	-26.3	4.0	NR
Microchip Technology Inc	14.2	79%	-5%	3.6	47%	8.7%	7.0%	3.3	-41.6	4.0	-1.2	-1.2	-11.4	-8.8	0.0	7.7	4.0	Restricted
Altera Corp	13.6	76%	-9%	5.1	59%	8.6%	n/a	3.0	-21.5	4.0	3.3	-1.1	0.7	-1.1	1.0	0.0	5.0	Neutral

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Factset, Credit Suisse HOLT, Credit Suisse research

Our overall strategy on cyclicals is:

(1) to be closer to the consumer than the corporate for two reasons: first, we believe nearly all of the global policy response will favour the consumer—falling rates and fiscal easing (which especially in the UK has been very consumer focused); and second, they are benefiting from falling commodity prices. We believe that consumption in Europe, US and UK in 2009 will be -1%,-2% and -2% compared with -3.8%, 0.2% and -0.5% currently (3Q, annualised);

(2) to be a small overweight of technology;

(3) to focus on some of the explicit green and infrastructure names on page 51; and

We prefer to play the credit-related areas rather than cyclicals.

Autos: Reduce the size of underweight

We have revised weightings up because of valuation, but we stay underweight. An already very low level of car sales (indeed car sales per capita are close to all-time lows) and the benefit to the business model of falling oil prices (as auto makers make most of their money from high-end vehicles). In addition, there has been a general recognition in the market of the problems that we highlighted at the start of the year (CO_2, auto leasing, overcapacity, operational leverage etc).

Figure 297: Cont Europe autos excl VW: P/B relative

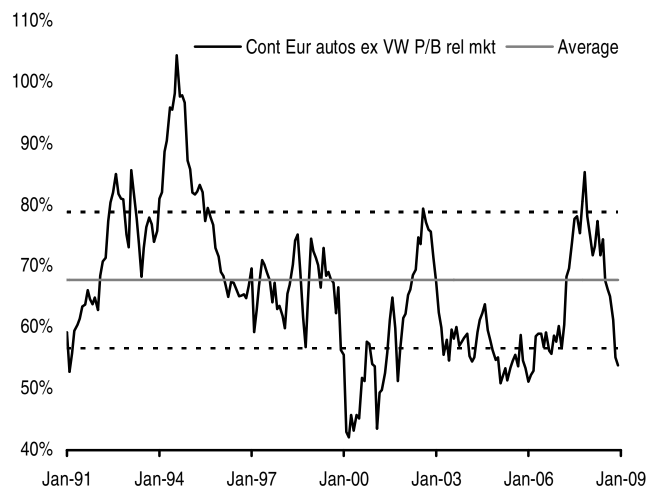

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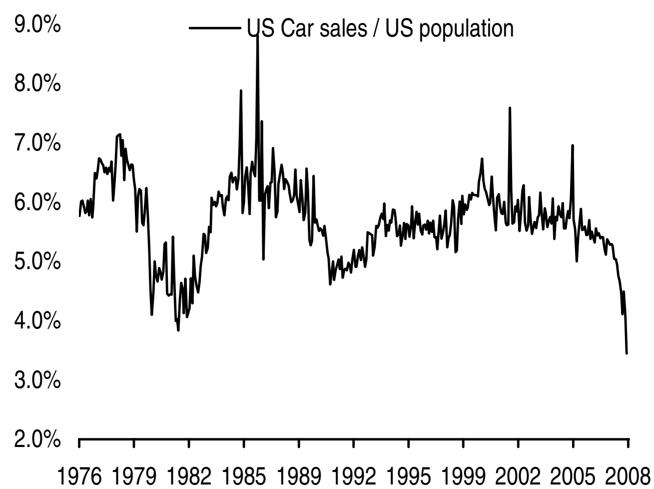
Figure 298: US car sales per capita



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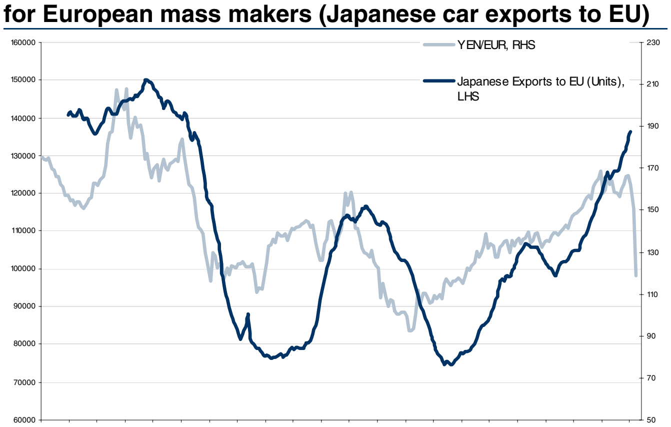
In addition, this sector should benefit from an improvement in the Yen/€ rate.

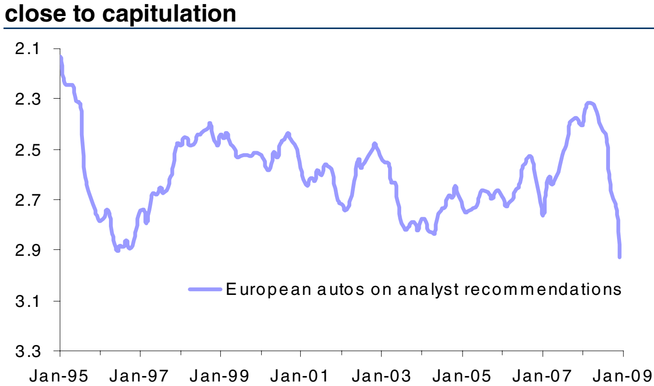
We have seen a virtual capitulation by analysts as well!

Figure 299: JPY / EUR should ease competitive pressure for European mass makers (Japanese car exports to EU)



Source: Credit Suisse European autos research team

Figure 300: European autos: Analyst recommendations—close to capitulation



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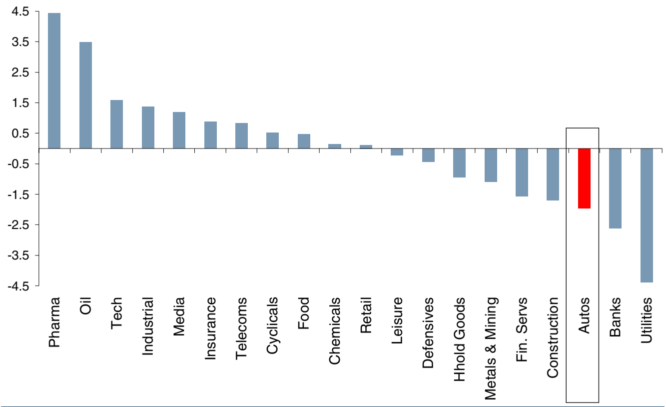
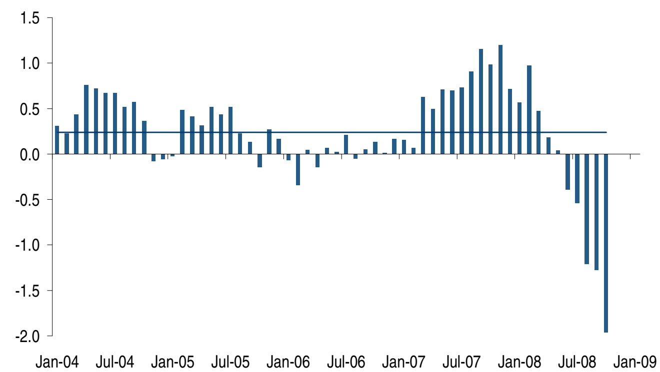
We have also seen capitulation on the European autos sector on the buy side if we look at the latest Frank Russell survey. Investors have been increasing the size of their underweight in autos for the past five months and autos is the third most underweight sector, according to this survey.

Figure 301: Frank Russell: European sector weightings relative to benchmark (free-float basis)



Source: Frank Russell, Credit Suisse research

Figure 302: Frank Russell: European autos weighting relative to benchmark (free float basis)



Source: Frank Russell, Credit Suisse research

We still want to be a small underweight as the sector is very highly operationally leveraged and has one of the highest income elasticity of demand (Figure 303).

Figure 303: Income elasticity of demand

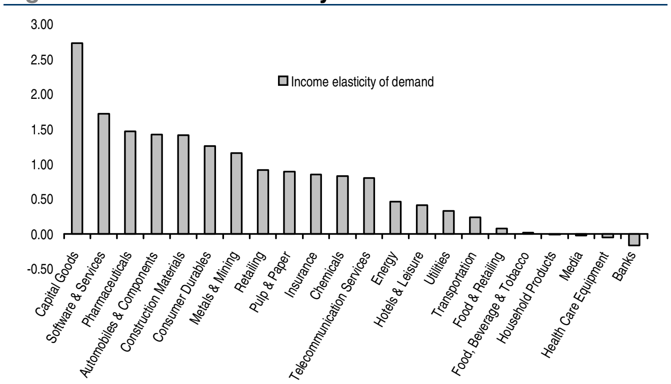


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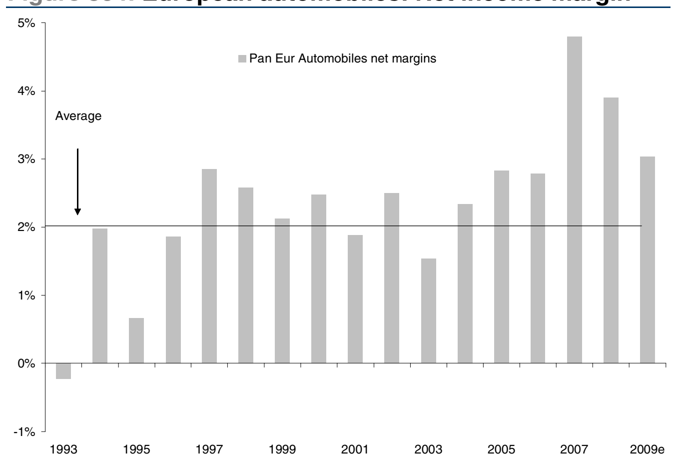
Figure 304: European automobiles: Net income margin



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Autos' net income margins look set to fall further. Consolidation looks limited by the fact that global market shares targets add up to 120% (!) and this, along with large barriers to exit, will likely mean that capacity is very slow to exit into the downturn. We are concerned about auto leasing (which accounts for 15% of assets).

In addition, the fall in the auto sector's relative CDS spread suggests that the sector should have underperformed by more than it has. In addition, earnings momentum is still below average.

Figure 305: European autos (ex VW) have performed better than their CDS spreads would have suggested

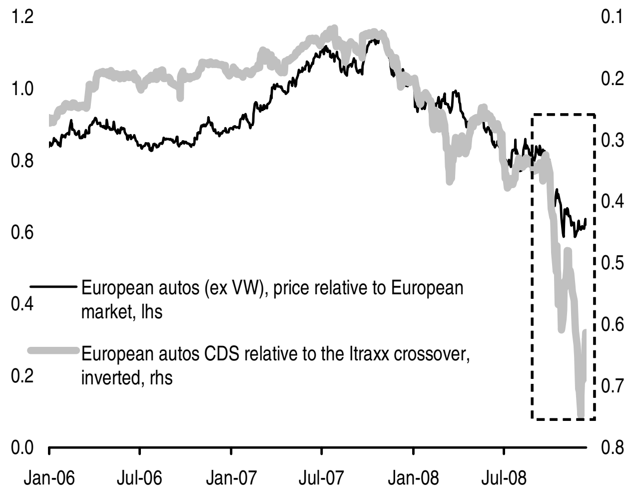

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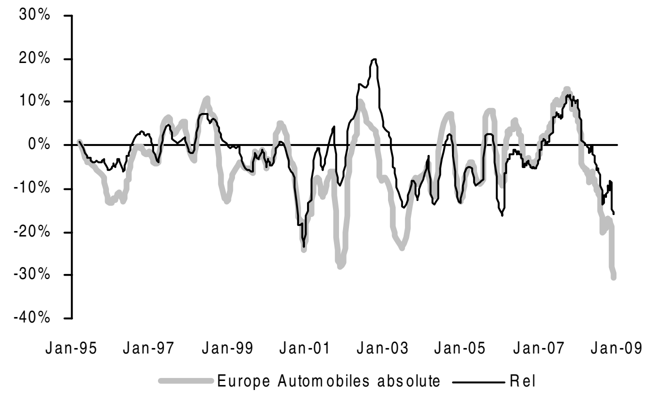
Figure 306: European autos earnings momentum



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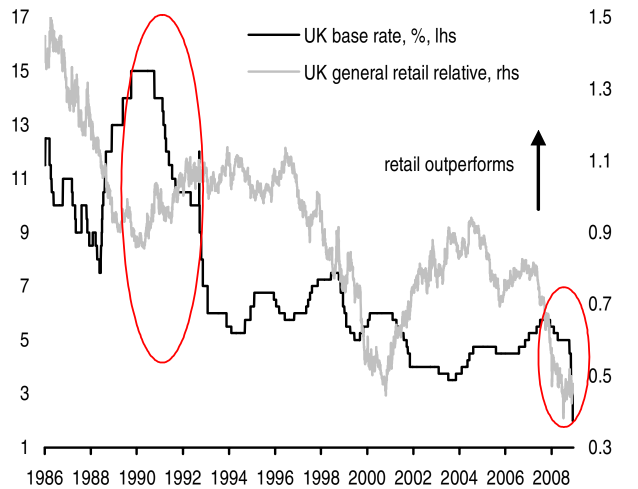
Credit Suisse's European autos team's top underperform stocks are Renault and Fiat. Their top outperforms are BMW and Michelin.

Retailing: Stay underweight

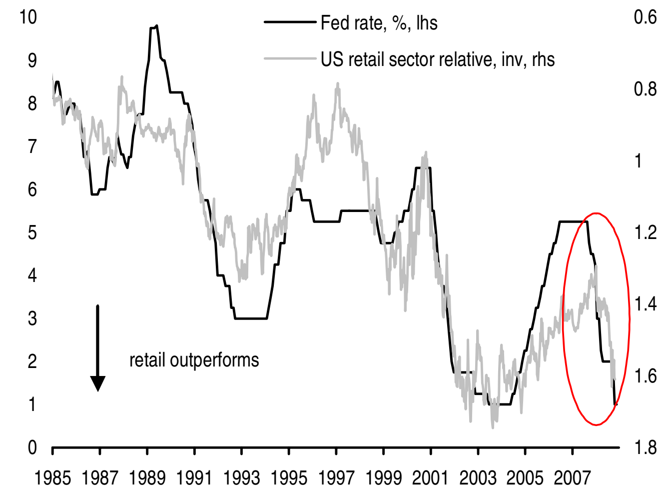
We reduced our underweight of UK retailing in November to be just 10% underweight(*What to do with cyclicals?*, dated 12 November 2008). The main reason for this move was that UK retail outperformed in the early 1990s by 30% between 1990 and 1993 once rates were cut despite retail sales collapsing from 3% to -3%. Similarly, US retail outperformed by 30% once there was combined interest rate and tax cut in mid-January 2008. On our estimates, 83% of the fiscal easing announced in the recent UK Pre-Budget Report was aimed at the consumer.

Figure 307: UK retail outperformed by nearly 30% in the early 1990s



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 308: US retail outperformed by 30% in early 2008 following tax and interest-rate cuts



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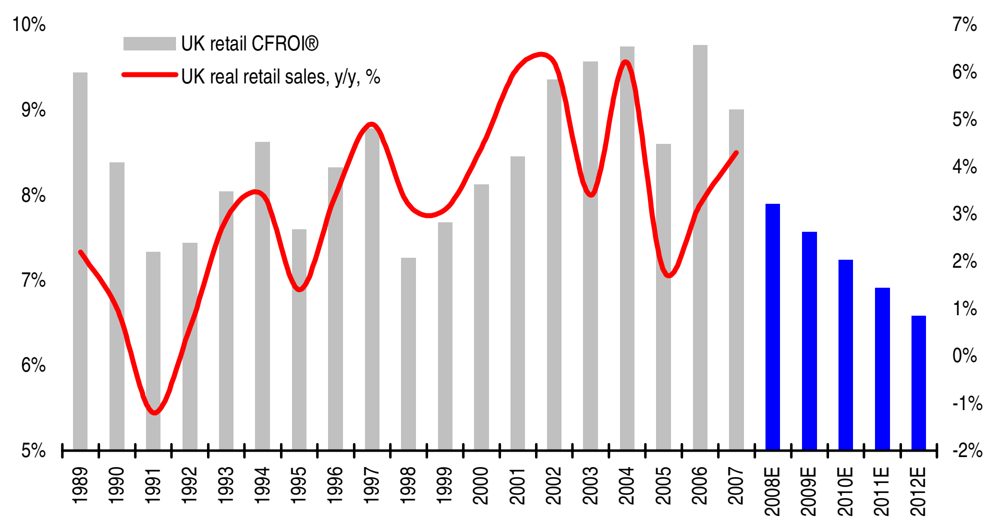
In terms of valuation, the UK retail CFROI® required on HOLT in order for the sector to be fair value relative to the market is at an all-time low.

Figure 309: UK retail CFROI® versus UK real retail sales



Source: Credit Suisse HOLT, Credit Suisse research

Figure 310: **UK retail on HOLT: Model inputs and outputs**

Sector name	CFROI		Implied CFROI® fade	Model inputs			Historical average (15 years)	
	2008E	Required FY5		Length of fade (y)	Assumed RAGR	Real cost of capital	CFROI®	RAGR
UK retailing	7.9%	6.6%	-1.3%	5	0.5%	6.0%	8.6%	2.4%

Source: Credit Suisse HOLT, Credit Suisse research

In addition, we are now seeing store closures. MFI/ Woolworths closures could potentially lead to a loss of about 1% of floor space.

However, we remain underweight as:

(a) Our view is that UK consumption could easily fall 2.5% next year (and retail sales by 5%) owing to the likely rise in the savings ratio to 5% (from 0% currently) and the fall in employment growth (from 1.5% yoy in early 2008 to -2% yoy).

(b) The rise in floor space is still around 2.5% pa. However, if we adjust for MFI / Woolworths it is closer to 1% pa.

Figure 311: **UK employment looks set to decline**

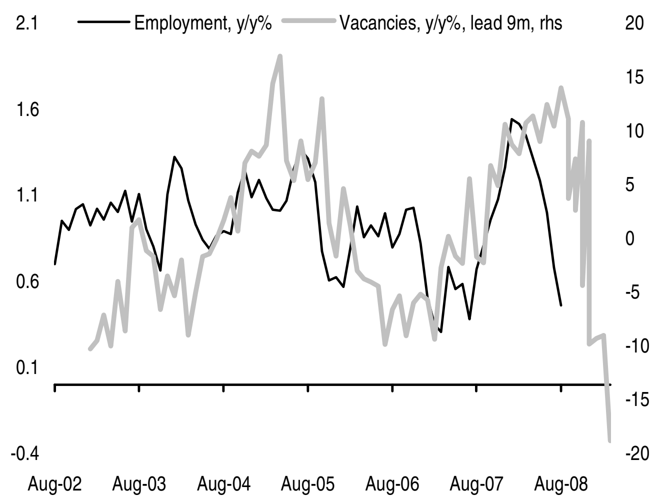


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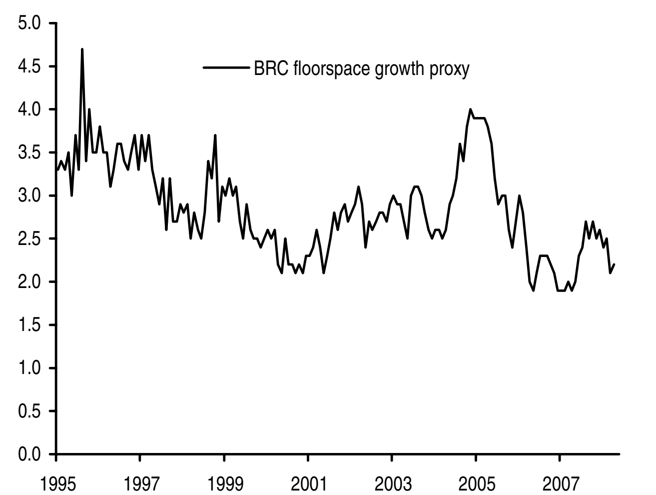
Figure 312: **Rising floorspace in UK will hit margins**



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(c) The lagged effect of sterling weakness. Although we believe that the majority of sterling's weakness has occurred, Credit Suisse's European retail team believes that there is a lagged effect on margins of around 6–9 months.

Figure 313: Trade-weighted sterling has fallen 26%

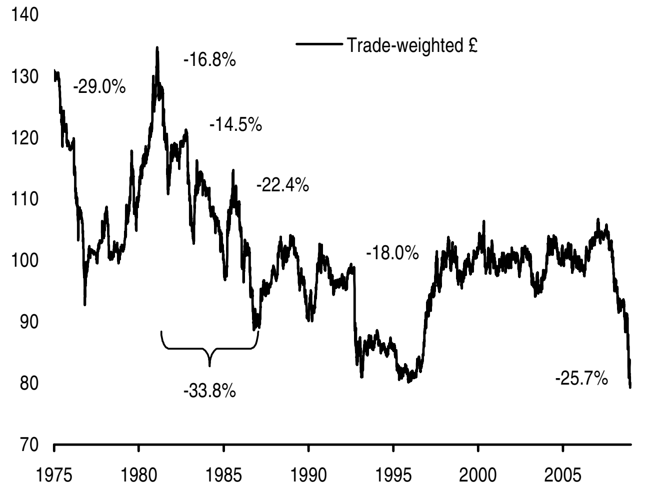

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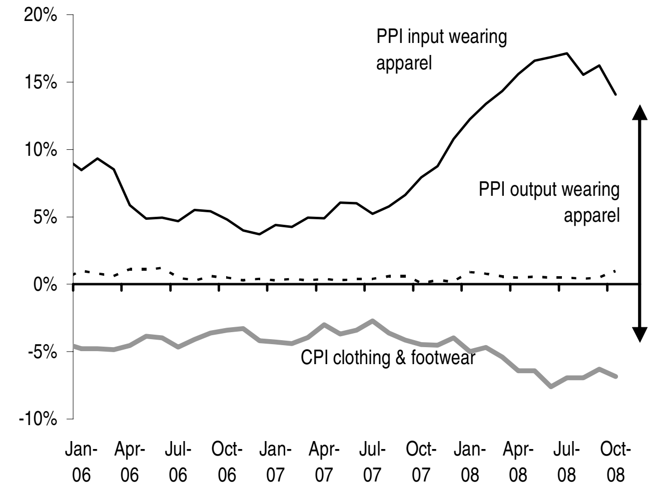
Figure 314: The gap between input prices and high street prices suggest further pressure on margins



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(d) The negative structural backdrop of the internet (which cannibalises conventional retail sales and limits the impulsive buyer as well as aiding price visibility) and the Tesco effect (which is growing like for likes at 2% and has lower margins than non-food retailers).

(e) Traditional valuations are not attractive. The forward P/E ratio relative to the market is in line with its long-run average, while P/B and dividend yield relatives have bounced off their lows.

Figure 315: UK retailing sector's 12-month forward P/E relative to the UK market

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 316: UK retailing sector's P/B relative to the UK market

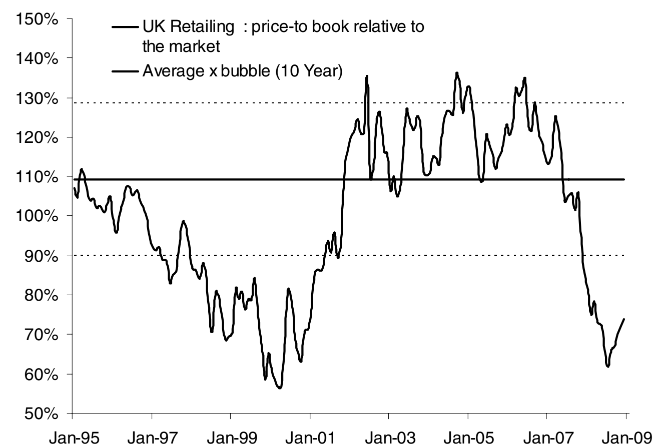

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Figure 317: **UK retailers that look expensive on HOLT**

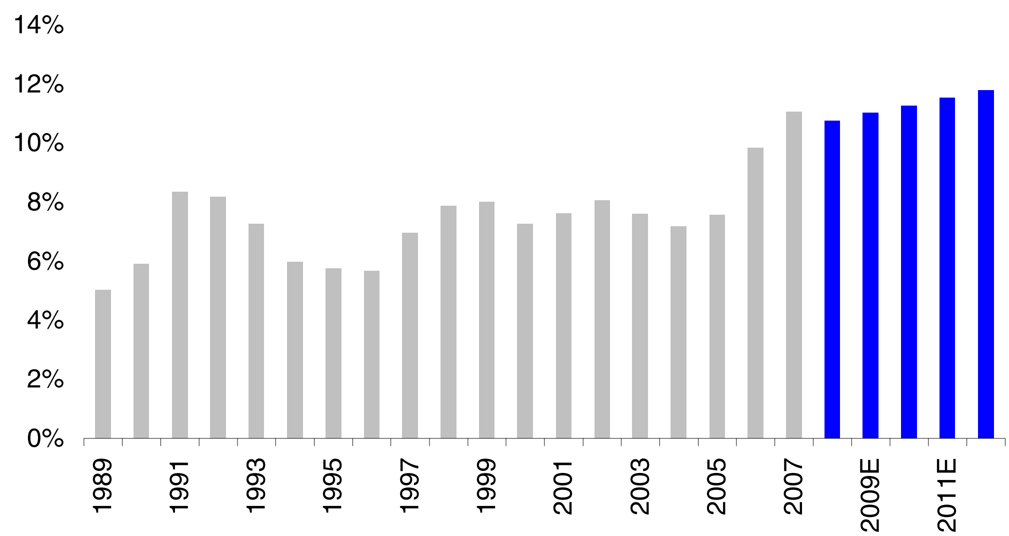
	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Asos Plc	16.9	95%	n/a	11.9	n/a	0.3%	0.2%	0.9	-24.1	1.0	6.0	-2.1	-0.1	8.8	1.0	80.0	2.0	NR
Kingfisher	13.6	103%	55%	0.6	-49%	-1.2%	3.9%	2.2	-84.3	2.0	-0.7	0.0	-2.6	-1.4	0.0	-69.2	3.0	Neutral
Marks & Spencer Gp	10.1	85%	5%	2.0	-6%	-5.8%	7.5%	0.3	-32.0	3.0	-3.0	-1.7	-9.3	-1.4	0.0	-44.0	4.0	Underperform
Mothercare	10.1	85%	7%	1.4	43%	10.1%	4.0%	3.7	-77.7	3.0	1.0	0.2	-5.4	0.0	1.0	50.0	4.0	NR
Carpetright	11.6	88%	35%	3.6	-55%	-3.5%	7.8%	1.8	-85.3	3.0	-2.3	-4.2	-25.5	-3.8	0.0	-100.0	4.0	NR
Home Retail Group	11.6	66%	n/a	0.6	n/a	9.2%	5.9%	0.6	-33.6	4.0	-1.7	-0.4	-10.7	-3.3	0.0	-63.6	5.0	Neutral
Kesa Electricals	7.9	60%	-4%	1.4	-50%	4.2%	11.5%	2.5	-76.7	4.0	-1.7	-2.9	-19.1	-1.6	0.0	-54.6	5.0	Underperform
Sports Direct Intl	6.5	49%	n/a	1.5	n/a	-44.7%	9.2%	-1.9	-181.9	4.0	-3.0	-25.0	-30.8	-3.9	0.0	-100.0	5.0	NR
Hmv Group	8.5	64%	31%	7.3	n/a	12.2%	6.8%	0.3	-68.5	4.0	0.5	-6.1	-6.5	-1.4	0.5	-52.4	5.5	Underperform
Debenhams	3.5	29%	n/a	1.2	n/a	43.1%	17.1%	0.9	-252.6	4.0	-1.9	0.0	-0.2	0.6	0.5	-71.4	5.5	Neutral
Dunelm Group Plc	9.0	68%	n/a	3.6	n/a	8.4%	3.4%	-4.3	-32.2	6.0	1.3	0.0	-0.2	0.0	0.5	0.0	6.5	NR

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

European retailing is still a clear underweight in our view given its valuation and sourcing issues:

Valuations on all measures (HOLT, P/B, P/E and dividend yield relatives) look unattractive.

Figure 318: **Europe ex UK retail requires a record CFROI® level in order to be fair value relative to the market**



Source: Credit Suisse HOLT, Credit Suisse research

Figure 319: **Europe ex UK retail: Model inputs and outputs**

Sector name	CFROI®		Implied CFROI fade (percentage points)	Model inputs			Historical average (15 years)	
	2008E	Required FY5		Length of fade (y)	Assumed RAGR	Real cost of capital	CFROI	RAGR
Europe ex UK retail	10.8%	11.8%	1.0%	5	1.0%	6.0%	7.6%	8.6%

Source: Credit Suisse HOLT, Credit Suisse research

Figure 320: **Europe ex UK retail P/B relative**

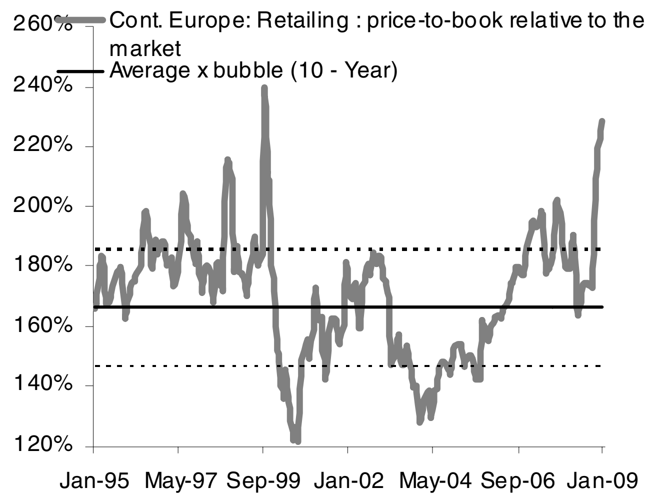


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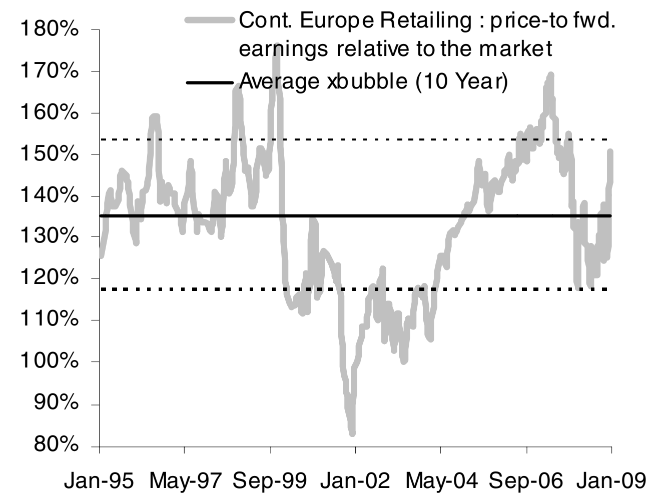
Figure 321: **Europe ex UK retail P/E relative**



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In addition, Euro ex UK retail is vulnerable to the weakness of the Euro, which will make sourcing goods more expensive. The sector's recent outperformance is inconsistent with the decline in the Euro against the US dollar (Figure 323).

Figure 322: **Europe ex UK retail dividend yield relative**

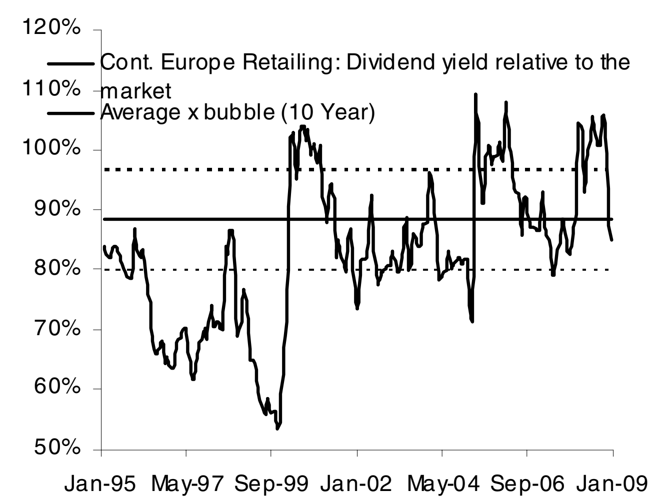

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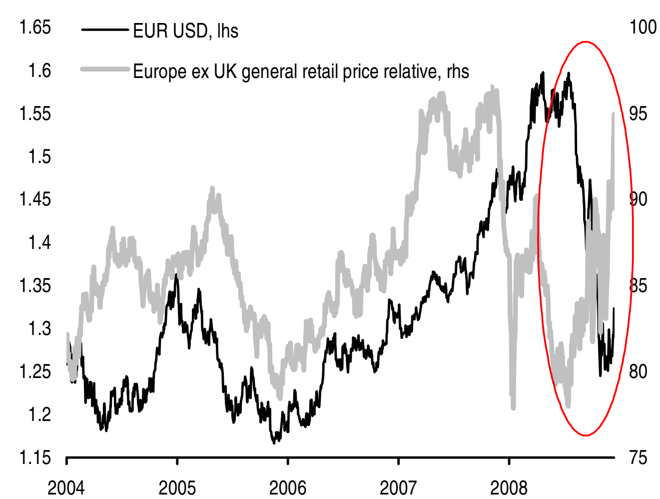
Figure 323: **Outperformance of retail is inconsistent with the fall in the euro**



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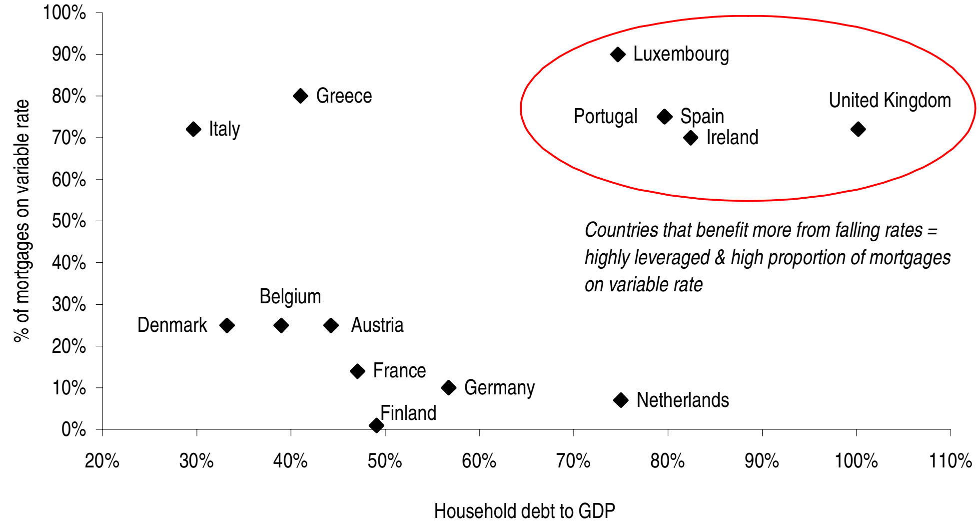
In the larger European countries, the consumer is far less sensitive to interest rates. In Germany and France, less than 15% of mortgages are on variable rates, compared with more than three-quarters in the UK. Consumer leverage is also lower in France (47% of GDP) and Germany (57% of GDP). Figure 324 shows that the countries most sensitive to falling rates are those where leverage is high and the majority of mortgage lending is at floating rates.

Figure 324: Continental Europe has lower leverage and fewer variable rate mortgages



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In Figure 325 we show Europe ex UK retailers that look expensive on HOLT.

Figure 325: Europe ex UK retailers that look expensive on HOLT

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Douglas Hldg Ag	13.2	100%	26%	1.8	10%	3.3%	3.7%	5.1	-36.0	2.0	1.2	-0.2	-0.5	-0.1	0.5	12.0	2.5	Neutral
Nfi Empik Media	9.8	74%	n/a	2.7	n/a	-11.0%	0.0%	4.9	-70.0	1.0	-0.7	1.7	-0.4	1.6	1.0	-66.7	3.0	NR
D'Ieteren Trading	4.3	40%	-55%	0.6	-41%	-70.3%	3.1%	1.2	-89.6	3.0	-1.2	-1.2	-1.7	0.0	0.0	66.7	3.0	NR
Fielmann Ag	15.0	114%	29%	3.9	108%	5.9%	4.5%	9.0	-49.0	2.0	2.6	2.6	3.7	0.0	1.5	56.5	3.5	NR
Inditex	13.3	100%	-2%	4.7	4%	5.0%	3.9%	1.5	-21.1	3.0	0.8	-4.4	-7.0	-2.7	0.5	42.9	3.5	Underperform
Praktiker Bau Hldg	7.4	56%	n/a	0.5	n/a	-0.4%	5.5%	2.4	-212.1	3.0	0.3	-0.3	-7.1	-1.9	0.5	40.0	3.5	NR
Kappahl Holding Ab	5.9	44%	n/a	4.1	n/a	-2.6%	16.3%	-1.5	-20.4	4.0	-4.9	0.0	-1.9	-0.5	0.0	25.0	4.0	NR
Gruppo Coin Spa	6.1	46%	-33%	0.8	-70%	-5.9%	3.0%	3.6	-115.2	4.0	0.5	-2.8	-25.8	-3.9	0.5	14.3	4.5	NR
Stockmann Oyj Abp	9.2	77%	-9%	0.9	-15%	-5.0%	9.0%	4.9	-125.3	4.0	0.0	-2.8	-20.3	-2.9	0.0	-42.9	5.0	NR
Clas Ohlson Ab	11.6	87%	n/a	2.9	n/a	3.8%	6.5%	-0.5	-29.3	4.0	-3.2	-18.5	-24.8	-7.6	0.0	-77.8	5.0	NR
Mekonomen Ab	11.9	90%	n/a	3.0	n/a	8.4%	8.5%	14.7	-39.7	4.0	11.4	-1.8	-6.0	-1.1	0.5	-14.3	5.5	NR
Valora Holding	8.3	63%	-9%	0.8	-24%	9.6%	6.1%	3.7	-55.3	5.0	-1.1	-6.6	-23.3	-0.2	0.0	-42.9	6.0	Underperform
Ppr	6.2	52%	-32%	0.6	-58%	13.2%	8.6%	3.9	-36.5	5.0	1.3	-1.8	-5.6	-0.7	0.5	-11.1	6.5	Neutral

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

Banks: Stay underweight banks in Europe

We stay underweight banks in Europe for the following reasons:

(1) They do not look cheap enough

On conventional measures banks may look cheap, but . . .

Figure 326: **European banks look very cheap on a P/B basis . . .**

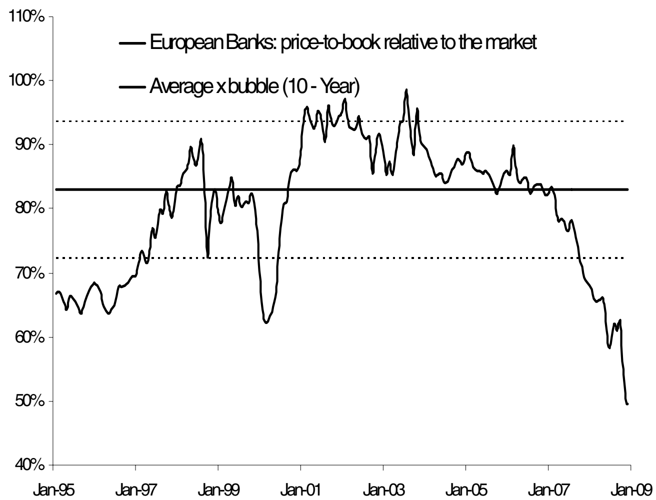

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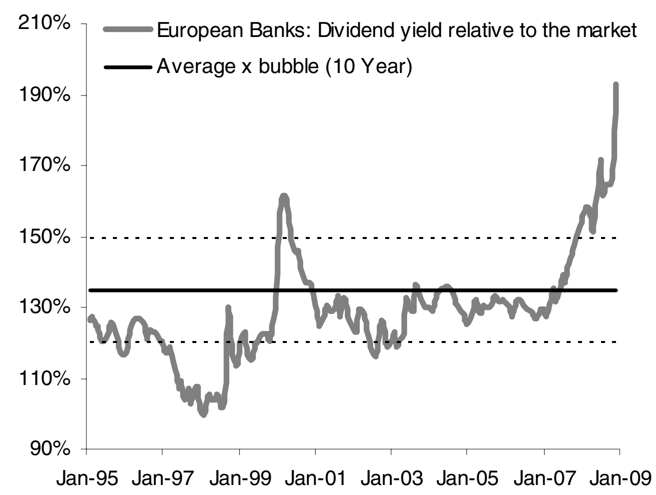
Figure 327: **. . . and look attractive on dividend yield**



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. . . at the trough of a credit crisis, banks trade on about 0.7x tangible book. European and US banks are still above that level.

Figure 328: **Global banks: P/B and P/TBV—current crisis versus previous crises**

------------- Previous banking crises -------------					
Country	**Peak to trough % banks sector price decline**			**Price to book at trough in equity price**	**Trough price to tang. book**
Denmark	Nov-89	Oct-92	-58%	0.54	0.54
Finland	Apr-89	Sep-92	-95%	0.33	n/a
Japan	Dec-89	Oct-98	-89%	1.14	n/a
Sweden	Jul-89	Nov-92	-89%	0.15	n/a
United Kingdom	Feb-90	Sep-90	-30%	0.74	0.82
United States	Oct-89	Oct-90	-45%	0.73	0.90
Korea	Nov-94	Sep-98	-91%	0.31	n/a
Malaysia	Feb-97	Aug-98	-84%	0.55	0.74
Average			-71%	0.56	0.75
------------- Current cycle -------------					
Country	**Peak to trough % banks sector price decline**			**Current P/B**	**Current price to tang. book**
UK	Feb-07	Nov-08	-70%	0.50	0.72
US	Feb-07	Nov-08	-70%	0.73	1.74
Europe ex UK	Apr-07	Nov-08	-74%	0.55	0.92

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Figure 329: **Global banks: P/B versus previous crises**

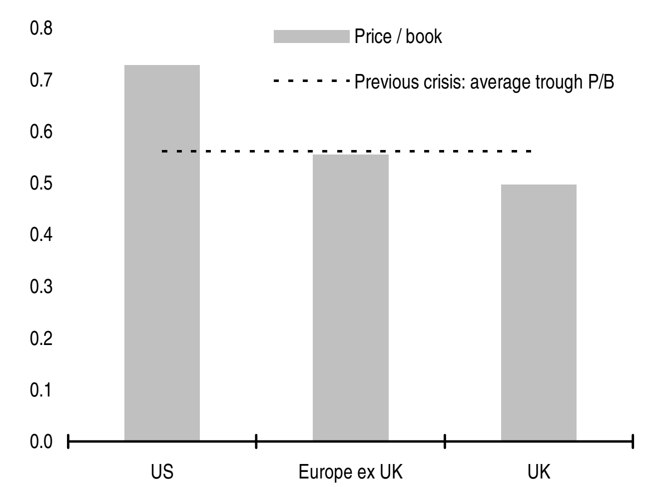

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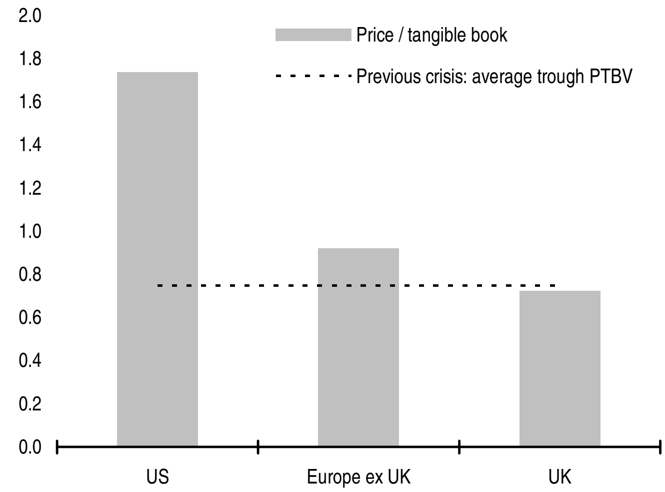
Figure 330: **Global banks: P/TBV versus previous crises**



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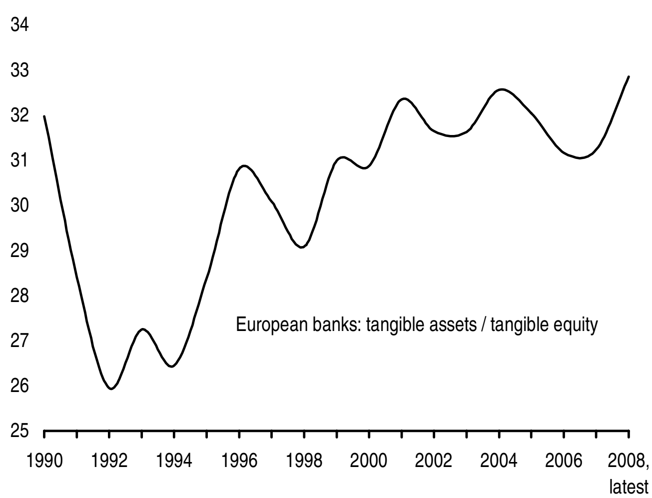
In addition, on the stress-test scenario set up by Credit Suisse's European banks team (which assumes a 10% rise in risk-weighted assets, a further 15% write-down of toxic assets, 200bp of impairments and a 15% fall in pre-provisioning profits), European banks are on a P/B of 1.2x.

Yet, even if we accept that European and UK banks are close to previous crises' lows, we would still be cautious as we worry that this time around the banking crisis is much more severe than on previous occasions. Why?

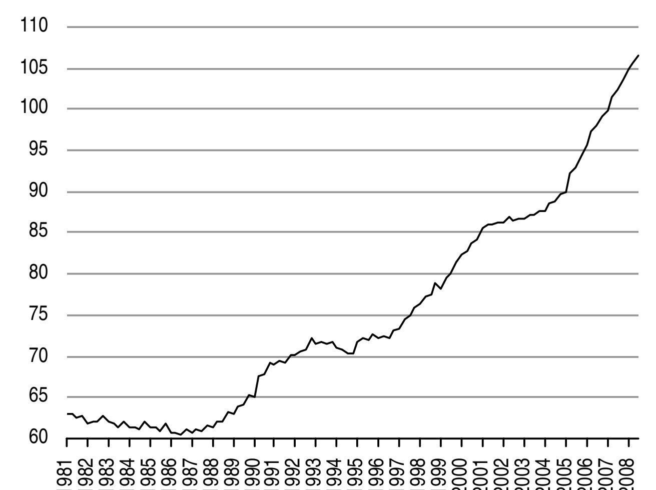
(i) Leverage of both customers and banks is more extreme.

Figure 331: **European banks: Tangible assets to tangible equity**



Source: Credit Suisse HOLT

Figure 332: **Euro-area private sector credit, % of GDP**



Source: Credit Suisse economics team

(ii) the reliance on securitised funding is more extreme with loan to deposit ratios well above average levels in all countries apart from Germany and Japan.

(iii) The reliance on mark-to-market (though now watered down) has meant losses have had to be realised before the yield curve has steepened and NIMs could expand. BIS 2 is also much more pro-cyclical (though again this will probably be watered down). The end of general provisioning meant that banks entered this downturn with much lower provisioning levels than normal (Spanish banks have been the salutary exception).

(iv) For the first time, we have had a credit crisis (as in 1987 and 1998) and a banking crisis (as in 1990 and 2001) occurring together in a severe form. There is a loss of trust in dis-intermediation.

(2) Banks typically trough around a year before the trough in property prices
Essentially, banks have ended up becoming huge hedge funds on property as the majority of their exposure now is to the property market.

Figure 333: **Banks' lending to property and construction by country**

Country	2000	2008	Difference
Ireland	39%	77%	38%
Spain	59%	84%	25%
South Africa	30%	49%	19%
US	45%	57%	12%
Japan	33%	42%	8%
UK	60%	68%	8%
Italy	30%	35%	5%
Germany	35%	37%	2%

Source: Credit Suisse Banks team

Figure 334 and Figure 335 show the increase in exposure for the UK and US.

Figure 334: **Proportion of UK bank loans outstanding to real estate-related areas**

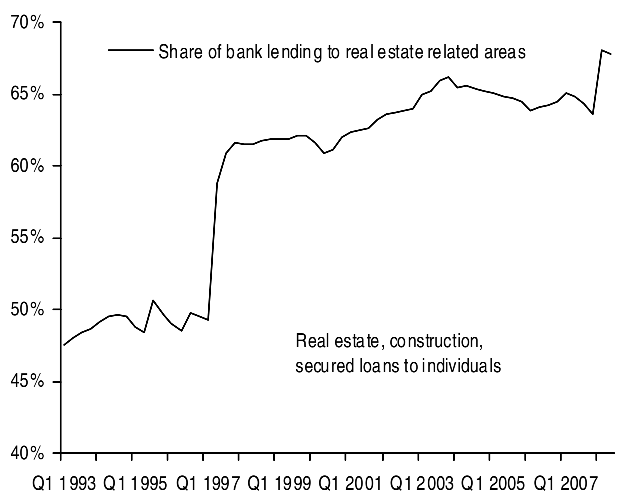


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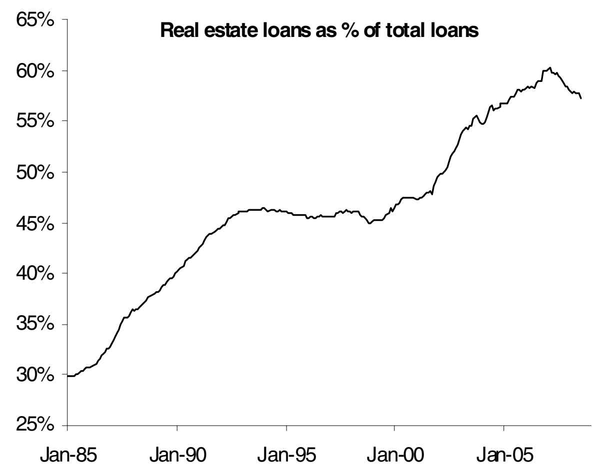
Figure 335: **US: proportion of banks to mortgages, commercial estate and construction**



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In the UK and US in the 1990s, banks did not sustainably outperform until 6–10 months before the trough in house prices and 3–6 months before the trough in mortgage approvals.

Figure 336: UK banks' relative performance and house prices

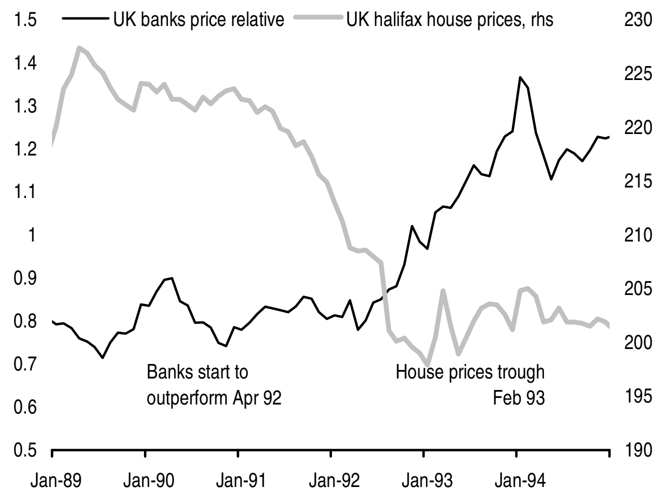

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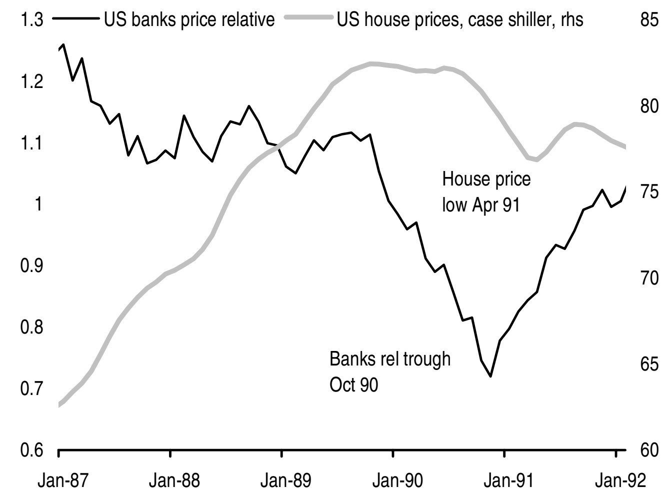
Figure 337: US banks' relative performance and house prices (case/Shiller Index)



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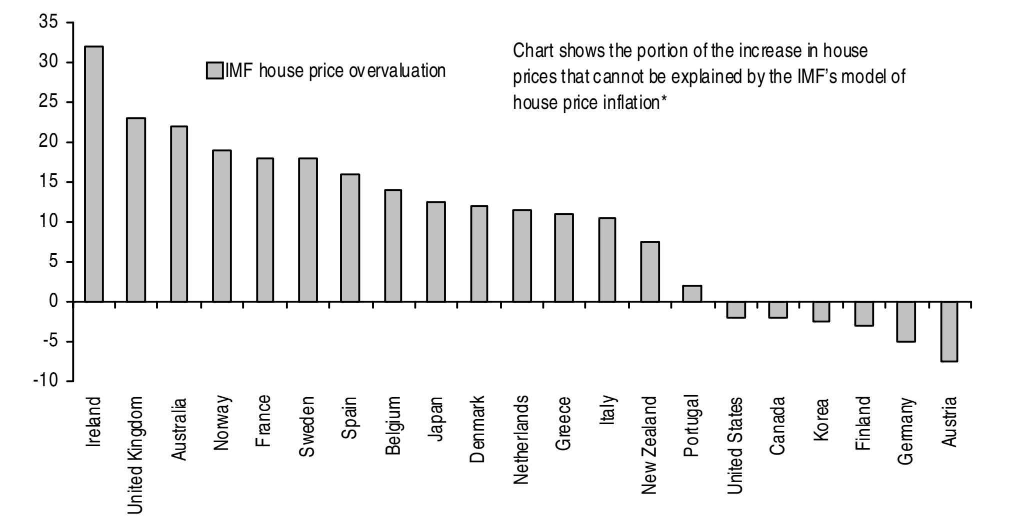
Housing still looks overvalued everywhere except for Germany and now the US.

Figure 338: Housing looks overvalued almost everywhere except for the US and Germany



**IMF model of house price inflation is based on affordability, change in disposable income per capita, short rates, long rates, credit growth, equity prices, working age population*

Source: IMF

Normally, it takes around 4.5 years for property values to trough (Figure 339).

Figure 339: **Declines in UK and US real house prices**

UK	Peak	Trough	Duration (qtrs)	Real fall
	3Q73	2Q77	15	-32.1%
	4Q79	2Q82	10	-17.1%
	2Q89	4Q95	26	-37.4%
	3Q07	to date	4	-15.2%

US	Peak	Trough	Duration (qtrs)	Real fall
	May-79	Sep-82	13	-11.3%
	Aug-89	Feb-97	23	-25.9%
	Oct-05	to date	4	-20.6%

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If we apply this rule of thumb, property should trough in around 1.5 and 2.5 years time in the US and the UK, respectively.

We believe (see the property section) that commercial property yields should be around 3% pts above the bond yield and thus commercial property currently looks overvalued almost everywhere (except in North America).

Figure 340: **Commercial property yields minus bond yields**

Country	Property yield (%)	Bond yields	Property yields minus bond yields
US	5.8	2.5	3.3
Canada	6.1	3.1	3.0
Switzerland	5.1	2.2	2.8
Singapore	5.0	2.1	2.8
New Zealand	7.7	4.9	2.8
Japan	3.9	1.4	2.5
Belgium	6.3	4.0	2.3
United Kingdom	5.8	3.6	2.2
Sweden	5.0	2.8	2.1
Greece	7.2	5.1	2.0
Hong Kong	3.6	1.6	2.0
Netherlands	5.8	3.8	2.0
Norway	5.8	4.0	1.8
Finland	5.5	3.9	1.6
Germany	4.6	3.2	1.4
Australia	5.4	4.3	1.1
Italy	5.5	4.5	1.0
Russia	9.4	8.6	0.8
France	4.4	3.6	0.8
Spain	4.7	4.0	0.7
Denmark	5.2	4.9	0.3
Austria	3.9	4.1	-0.2
Ireland	3.9	4.4	-0.6

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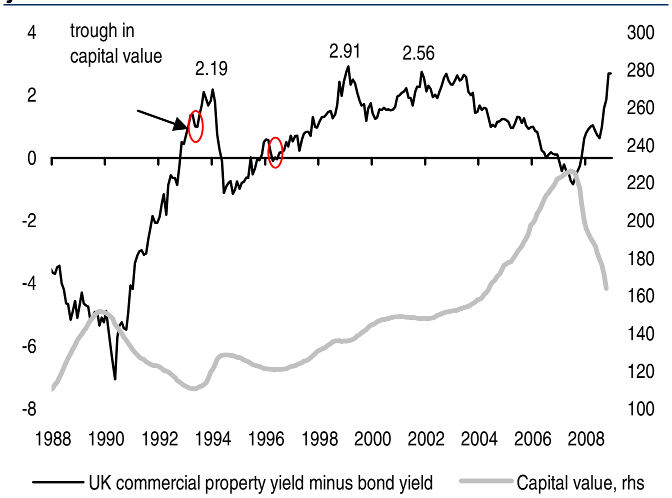
Figure 341: **UK commercial property yields minus bond yields**



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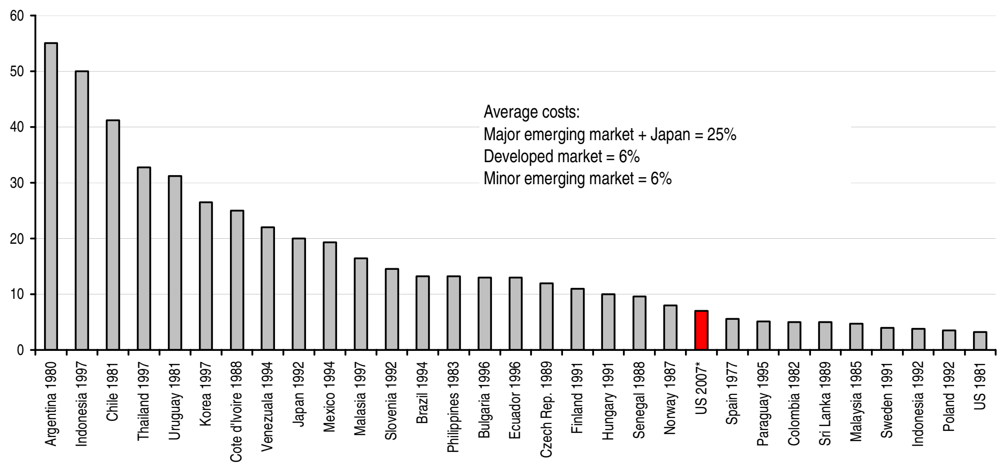
(3) Dilution

Capital raising is needed for two reasons:

(1) The need to de-leverage: we estimate that banks in Europe and the US require a total of US$200bn to return to average leverage levels.

(2) Write-offs: In a normal banking crisis, we would expect about 6% of GDP to be written off.

Figure 342: **Fiscal costs of banking crises, % of GDP, World Bank**



** Credit Suisse Global Strategy estimate*

Source: World Bank, Credit Suisse estimates

If the total credit losses amount to about 6% in the most affected countries (US, UK, Spain and Ireland), they sum up to around US$1.3tn. If we assume that banks account for 60% of write-offs, only another US$200bn has to be raised, in our view.

However, increasingly this looks anything but a 'normal' banking crisis with most major indicators pointing to the worst economic environment since the 1930s. If the crisis turns out to be equivalent in relative size to the Finnish and Norwegian banking crises of the early 1990s, it would require write-offs to the tune of 10% of GDP in the countries that have experienced housing booms. In this case, further write offs of about US$600bn would be required, on our estimates. (See Figure 343).

Figure 343: **Further capital raising required by global banks under different loss scenarios**

Capital raising required by global banks (US$ bn)		
Total write downs, % of GDP (US, UK, ES & IR)		
	Scenario I: 6%	Scenario II: 10%
	Write-downs	
Total write-downs	1,300	1,900
Bank write-downs (60% of total)	780	1,140
Write-downs so far	730	730
Further write-downs required	50	410
	Capital raising	
Capital required to cover write-downs	780	1,140
Capital required for deleveraging	200	200
Total capital raising required	980	1,340
Capital raised so far	780	780
Further capital raising required	**200**	**560**

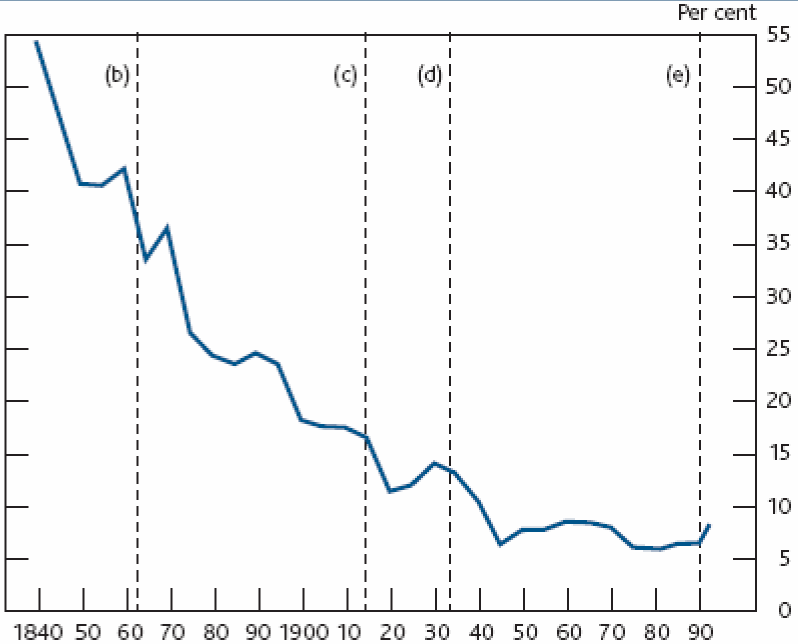
Source: Credit Suisse estimates

There are two issues to think about in this regard:

(3) The Bank of England estimated mark to market losses were US$2.8trn.

(4) Perhaps there needs to be a fundamental review of the amount of capital banks require—especially if we compare leverage to historical levels

Figure 344: **Equity as a percentage of assets (ratio of aggregate US dollar value of bank book equity to aggregate US dollar value of bank book assets)**



Source: Bank of England Financial Stability Report, Nov 2008

(b) National Banking Act 1863, (c) Creation of Federal Reserve 1914, (d) Creation of Federal Deposit Insurance Corporation 1933, (e) Implementation of Basel risk-based capital requirements 1990

We should also bear in mind that it is not unusual for banks to trough well after a 'life-boat' scheme has been announced!

Figure 345: **Historically, banks require a 'life boat' . . . and trough three months to 3.5 years later**

Crisis	"life boat"	Date of "life boat"	Purpose	Trough in equities	Trough in banks sector price	# mths between "life boat" and trough in banks and equities
US S&L crisis	Resolutions Trust Corp (RTC)	**Aug-89**	US government owned Co charged with liquidating assets/ closing insolvent thrifts/ providing funds to pay out insurance to depositors	**Oct-90**	**Oct-90**	15
Japan	Resolution and Collection Bank (RCB)	**Jan-95**	RCB established as takeover bank of bankrupted financial institutions. In April 1999 called RCC (Resolution and Collection Co)- with the purpose of collecting NPLs that bought from banks	**Oct-98**	**Oct-98**	45
Sweden	Swedish gov became general guarantor for all creditors	**Sep-92**	One of Sweden's largest banks- Gota- went bankrupt and Government announced a general guarantee for all creditors (except equity holders)	**Oct-92**	**Nov-92**	2 to 3

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Credit Suisse's European banks team estimates that the European banks may need to raise €42bn under their stress-case scenario.

(4) Regulation / government intervention

The signals are increasingly clear that governments might force banks to lend and limit the expansion in their NIMs. This could mean that: (a) governments nationalise banks to force them to lend; and (b) banks are unable to expand their NIMs in the normal way.

(5) Slowdown in loan growth

The tightening in lending standards in Europe and the US suggests that loan growth is going to be weaker than generally expected.

Figure 346: **US bank lending growth versus US lending standards**

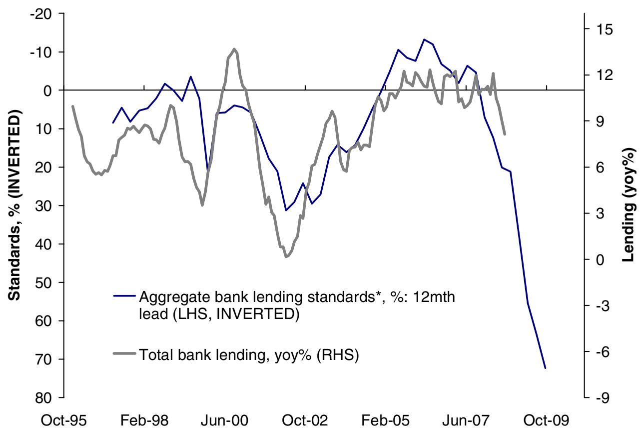

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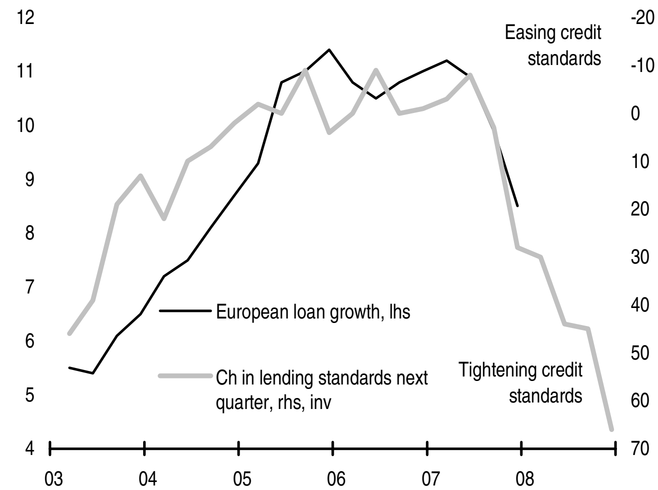
Figure 347: **European bank lending growth versus European lending standards (12m lead)**



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Banks normally trough three to six months before the trough in mortgage approvals but Figure 346 and Figure 347 show that year-on-year loan growth looks to be deteriorating for the next year.

Figure 348: **US banks' relative performance and mortgage approvals**

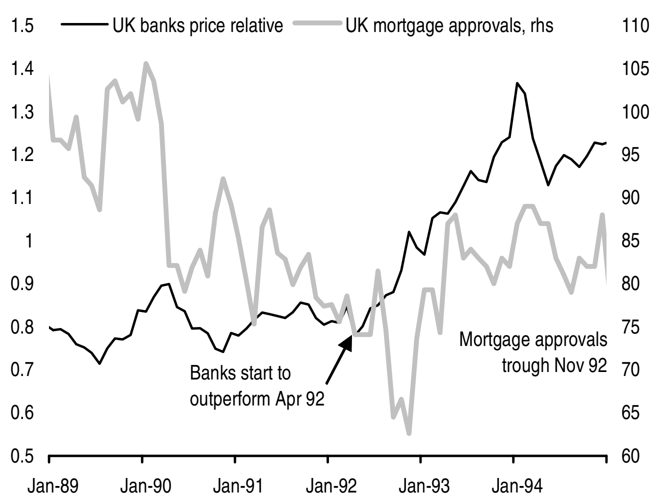

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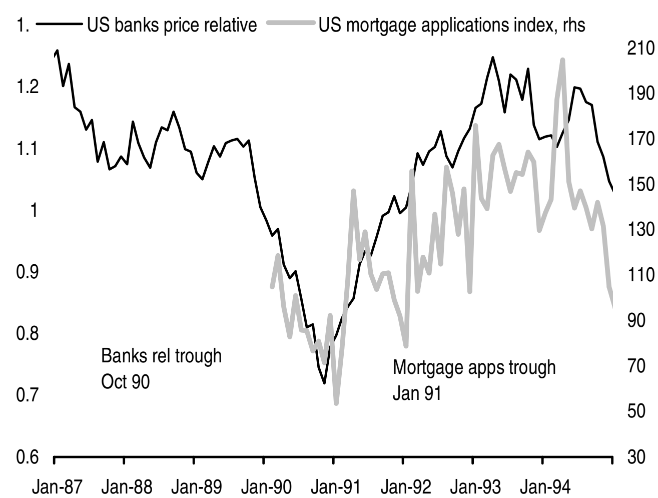
Figure 349: **US banks' relative performance and mortgage applications**



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(6) A fall in short rates is normally enough, but not in a banking crisis

A fall in short rates is enough when the credit mechanism is not broken. However, into a banking crisis, we can see that short rates often need to fall considerably before banks outperform, especially in the case of Cont. Europe.

Figure 350: US banks rel versus base rates

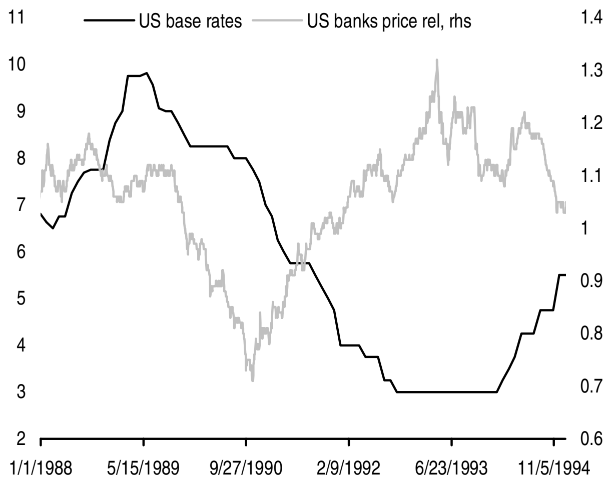

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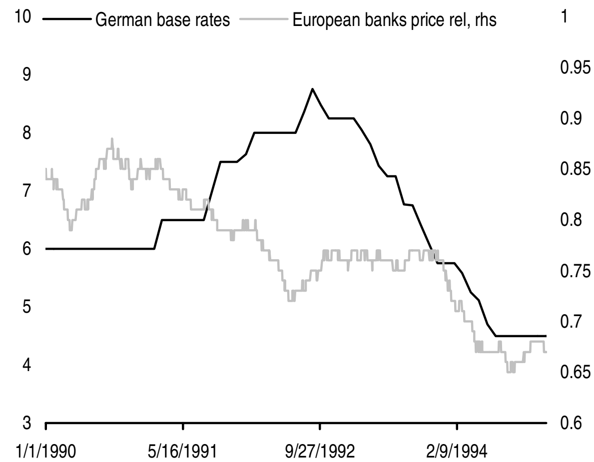
Figure 351: European banks rel versus base rates



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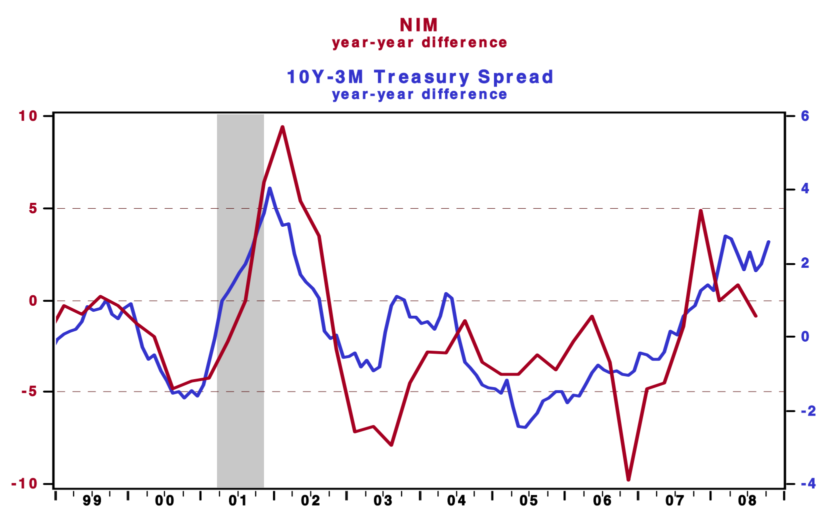
Indeed part of the reason UK banks started to outperform in May 1992 was because property affordability had returned to normal levels.

Even the steeper yield curve is of less help now. We can see that US banks' NIMs have not expanded as much as the yield curve relationship should have suggested. Moreover, in Europe nearly all the exposure to the yield curve has been swapped.

Figure 352: US banks net interest margin versus the US yield curve



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Importantly, the worse this crisis becomes, the more central banks will try to drive down the long end of the bond market, which will flatten the yield curve—not very helpful if you have to support the banking sector.

(7) Banks may be high beta into a stock market rally but do not lead the rally
In both 1989 and 2007, US bank stocks started falling around 5 to 9 months prior to the sell-off in equities. However, the lesson of the earlier episode is that banks do not necessarily lead the subsequent rally.

Figure 353: **Banks lead market sell-off by five months**

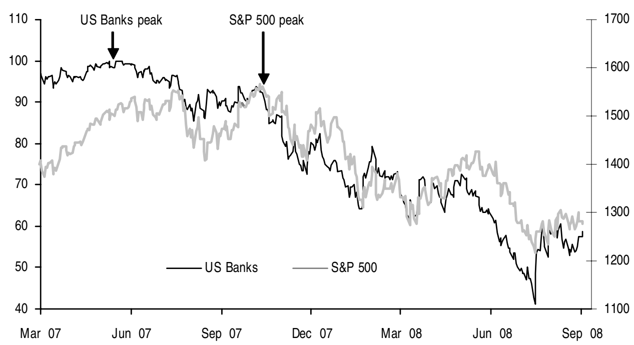

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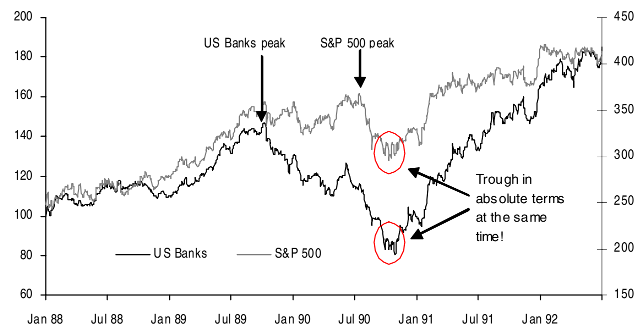
Figure 354: **In 1989 banks led the sell-off by nine months and the rally was coincidental**



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Which banks?

We continue to prefer the underleveraged banks. They should be able to expand NIMs much more than expected and are far less reliant on government funding or securitisation. In addition, they may be able to cherry pick assets relatively cheaply. Lowly leveraged banks and banks with a low loan deposit ratio have performed very well since the beginning of the crisis.

Figure 355: **European banks with low loan to deposit ratio versus European banks with high loan to deposit ratio**

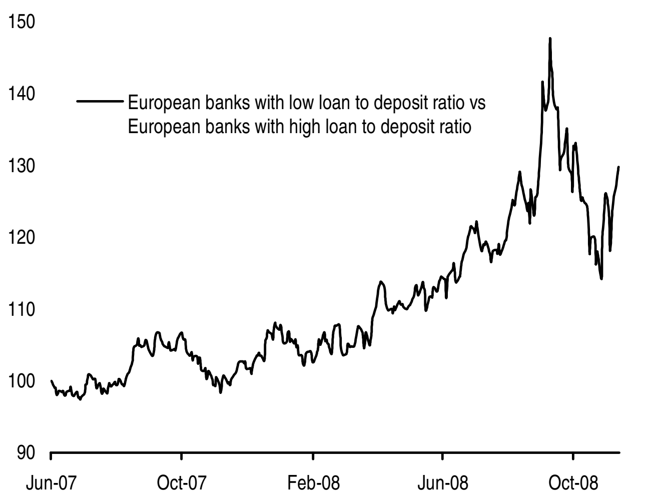

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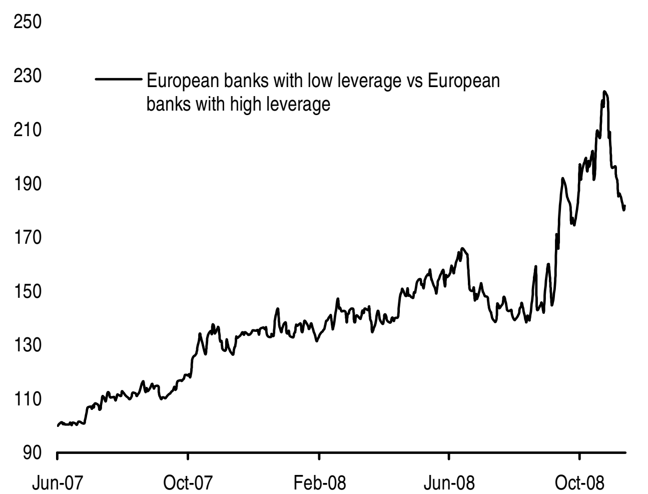
Figure 356: **European banks with low leverage versus European banks with high leverage**



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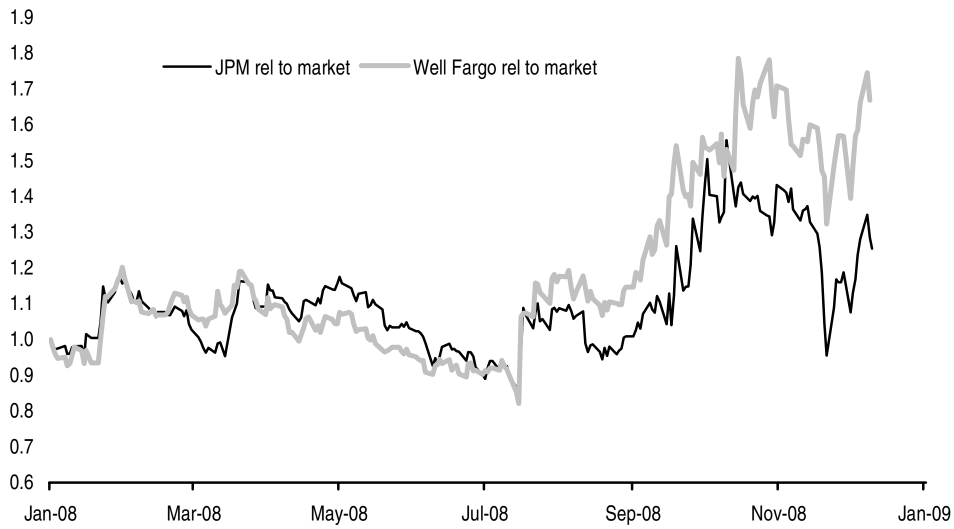
In the US, the lowly leveraged banks have been hugely re-rated and the performance of JP Morgan and Wells Fargo this year has been impressive.

Figure 357: JP Morgan and Wells Fargo have outperformed the market in the past six months



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In addition, we advocate buying banks in countries where the majority of their customers rank well on the following screens:

(1) consumer leverage is low;

(2) corporate leverage is low;

(3) financial product penetration rate is low;

(4) loan growth has been relatively low over the past five years; and

(5) property yields are high versus bond yields.

Figure 358 shows the developed countries that rank top on our underleveraged scorecard.

Figure 358: Underleveraged developed countries

Country	Corporate credit to GDP	HH debt to GDP	5y loan growth	Life premia, % of GDP	Property yields minus bond yields	Rank
Greece	42%	41%	14%	1%	2.0%	1
Belgium	36%	39%	8%	7%	2.3%	2
Germany	38%	57%	0%	3%	1.4%	3
Singapore	52%	43%	8%	6%	2.8%	4
Austria	53%	43%	6%	3%	-0.2%	5
Italy	55%	29%	7%	4%	1.0%	6
Sweden	40%	67%	8%	5%	2.1%	7
France	43%	46%	7%	7%	0.8%	8
Norway	49%	80%	n/a	3%	1.8%	9
Japan	75%	64%	0%	8%	2.5%	10

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Figure 359 shows the developing countries that rank top on our underleveraged scorecard.

Figure 359: Underleveraged developing countries

Country	Corporate credit to GDP	HH debt to GDP	5y loan growth	Life premia, % of GDP	Property yields minus bond yields	Rank
Mexico	13%	16%	14%	1%	1.1%	1
Czech Republic	19%	21%	16%	2%	1.9%	2
Russia	32%	10%	35%	0%	0.8%	3
Turkey	20%	12%	30%	0%	-9.1%	4
China	87%	19%	11%	2%	6.2%	5

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Clearly some of the underleveraged banks in our list of underleveraged developed countries are affected by other issues (eg, Eastern European exposure for KBC and the Greek banks). However, if we merely look for the least leveraged banks in the countries that rank well, we get NBG, Alpha Bank, Resona, Intesa and UOB.

Figure 360: Underleveraged banks in underleveraged developed countries-

Company	Country	Market cap	Tangible assets / tangible equity	Loans / deposits	12m fwd P/E	P/PPP	PTBV	Recommendations
KBC	Belgium	12,778	27.8	98%	5.6	9.0	0.7	Outperform
Alpha Bank	Greece	3,352	17.2	125%	4.3	2.0	0.7	Outperform
Agricultural Bank of Greece	Greece	1,752	16.5	87%	7.9	3.5	0.9	Neutral
EFG Eurobank Ergasias	Greece	3,886	23.2	122%	3.7	1.8	0.8	Outperform
National Bank of Greece	Greece	8,643	23.2	95%	4.6	2.7	1.4	Outperform
Intesa Sanpaolo	Italy	37,781	27.1	107%	5.9	3.5	1.3	Outperform
UBI Banca	Italy	9,812	19.5	123%	8.7	4.8	1.2	Neutral
Resona Holdings	Japan	16,732	18.6	79%	11.0	4.4	0.8	Outperform
Sumitomo Mitsui Financial	Japan	26,531	28.3	82%	7.9	2.6	0.7	Outperform
Sumitomo Trust & Banking	Japan	8,178	20.9	75%	11.7	3.8	0.8	Outperform
Oversea-Chinese Banking	Singapore	11,295	12.8	87%	11.1	8.0	1.2	Neutral
United Overseas Bank	Singapore	13,754	12.8	92%	11.0	6.9	1.4	Outperform

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We show the screen for the developing countries in Figure 361.

Figure 361: Underleveraged banks in underleveraged developing countries

Company	Country	Market cap	Tangible assets / tangible equity	Loans / deposits	12m fwd P/E	P/PPP	PTBV	Recommendations
Grupo Financiero Banorte	Mexico	3,299	10.0	99%	5.6	3.6	1.3	Outperform
China Construction Bank	China	141,479	14.5	61%	8.8	6.0	1.9	Neutral
Industrial & Commercial	China	47,797	16.4	57%	10.0	1.7	0.6	Neutral
China Merchants Bank - H	China	5,509	19.2	67%	9.1	1.1	0.6	Neutral
Bank of China Ltd	China	25,503	14.4	67%	6.8	1.4	0.4	Neutral
Komercni Banka	Czech	5,848	19.1	71%	9.8	8.1	3.3	Neutral
Sberbank	Russia	16,384	8.7	104%	3.7	2.0	0.6	Outperform
Vozrozhdenie	Russia	251	10.5	97%	1.5	1.3	0.5	Outperform

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The Japanese banks rank very well: The country is underleveraged (consumer and corporate leverage is low and Japan has net foreign assets equivalent to nearly half of GDP) and domestic sectors outperform in Japan when US credit spreads rise (ie, if the outlook for global risk assets deteriorates further Figure 362). Japanese banks also have a strong positive correlation with Japanese bond yields. Thus Japanese banks would outperform if credit spreads deteriorate or outperform if global growth recovers and bond yields rise—this seems an attractive risk reward to us.

Our Japanese banks' analyst Shinichi Ina points out, however, that the banks' equity holdings have suffered from the recent sell-off in the equity markets. As unrealised net gains / losses on these holdings are counted towards their regulatory capital, this might have a negative impact on the banks' Tier 1 ratio. Yet, he points out that: a) recently introduced special measures shield domestic banks' capital ratios from the impact of falling equity prices; and b) mega banks are raising capital.

Figure 362: Domestic Japanese sectors do well when US credit spreads are rising

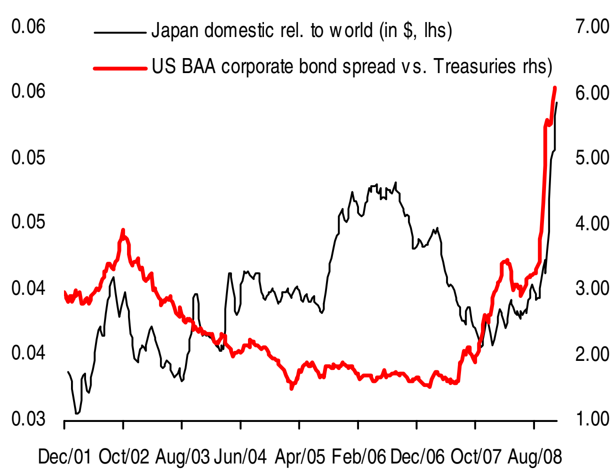

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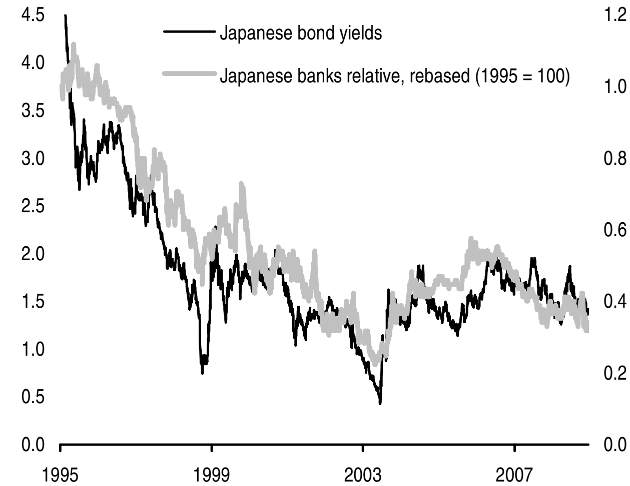
Figure 363: Japanese banks have a strong negative correlation with Japanese bond yields



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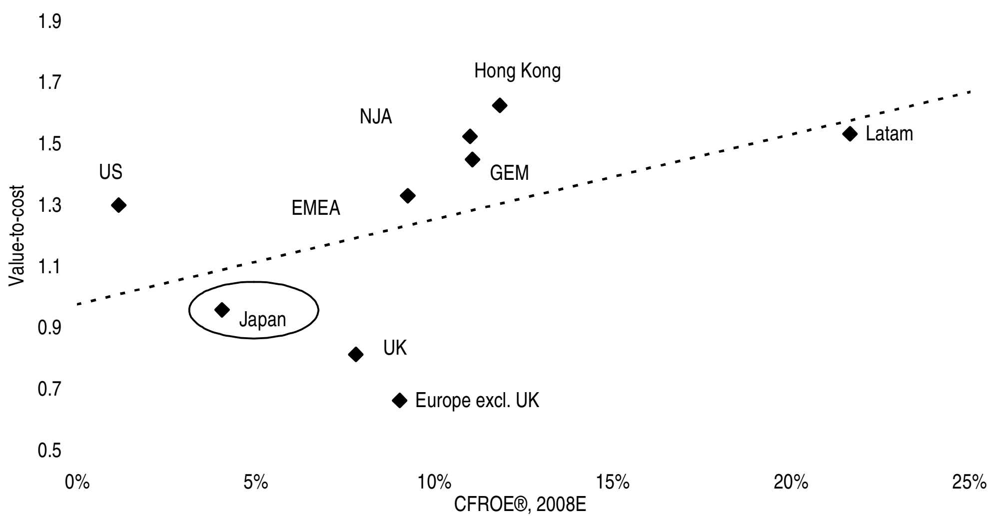
Their valuation is middling (Figure 364) yet banks have a low loan deposit ratio (75%) and a high cost to income (86%). (For more details see *2009 Outlook: Regional allocation*, dated2 December 2009).

Figure 364: Global banks on HOLT: CFROE® versus value-to-cost



Source: Credit Suisse HOLT

The investment banks (as they used to be) pose a dilemma as they are very correlated to credit (!) and have had a de-leveraged average RoE of around 12% over the past five years. This suggests that normally investors should be paying up to 1.1 book (assuming a cost of capital of around 11% and a growth rate of 2%). Investment banks have historically been very good at generating new business: around 40% of business in 2005 was not around in 2000. Currently we would confine ourselves to private banking funded investment banks that trade well below 1.5x tangible book: UBS is not quite there yet, trading at around 1.5x at the moment on our estimates.

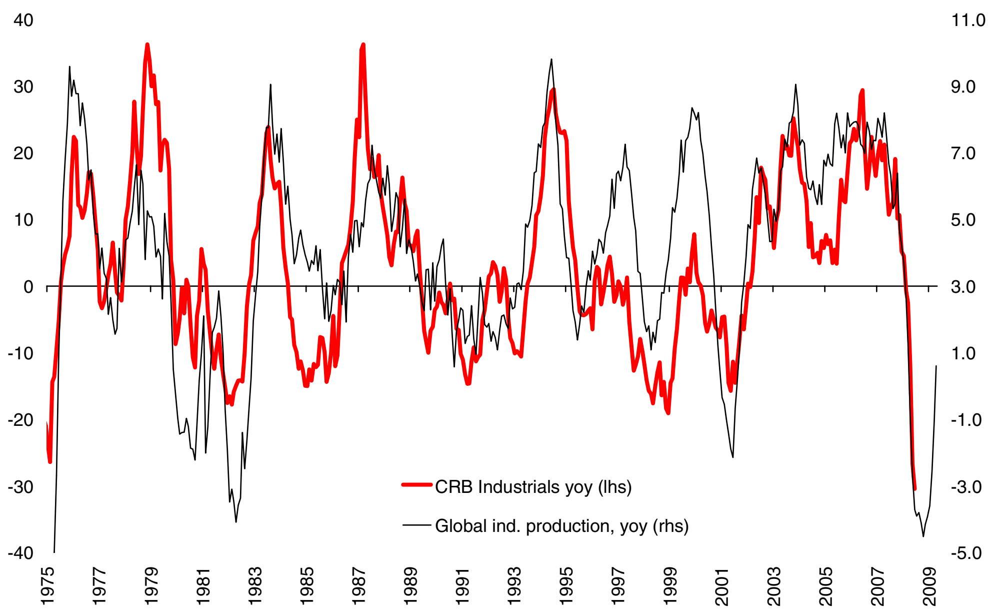
Our preferred investment bank proxies are Societe Generale and Goldman Sachs. 40% of Societe Generale PBT is investment banking related and its share price is among the most highly correlated to credit spreads in Europe (Goldmans also has one of the highest correlations with credit spreads in the US). Hence, both banks fit into our theme of playing credit. Currently Societe Generale and Goldman Sachs trade on 0.9x and 0.7x tangible book, on our estimates.

Mining: Keep a small underweight

(1) Industrial commodity prices are unlikely to stop falling until YoY IP growth troughs

Credit Suisse's global strategist Jonathan Wilmot estimates global IP to be around *minus* 3.7% in yoy terms in December and forecasts global IP to trough in April 2009 at *minus* 4.5% on a yoy basis (*minus* 13% on a 3mth/ 3mth annualised basis in December/January)- and it could get even worse (as the de-stocking intensifies). We believe that IP growth will trough only once the destocking is complete and we would seek confirmation in the PMI/ISM numbers prior to this. We can see in Europe, US and China that PMI inventories are still high.

Figure 365: **Global IP (on Jonathan Wilmot's forecasts) yoy**



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Apart from 1993, industrial commodity prices trough on average four months after the yoy trough in global IP (and on one occasion—in 2001—industrial commodity prices troughed a month after the trough in global IP). Thus we would expect to see industrial commodity prices trough in Q2.

Figure 366: CRB industrial prices versus global IP momentum and growth

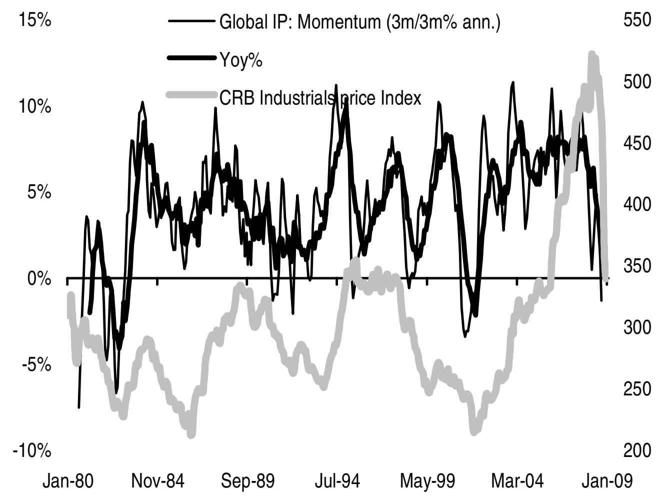

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Figure 367: Global IP growth tends to trough four months before the trough in commodity prices

Trough in CRB industrials price index	Trough in global industrial production			
	3m/3m	lead / (lag)	YoY	lead / (lag)
Jan-83	Aug-82	5	Oct-82	3
Sep-86	May-86	4	May-86	4
Oct-93	Feb-92	20	Nov-92	11
Nov-01	May-01	6	Dec-01	-1
	Average	9		4

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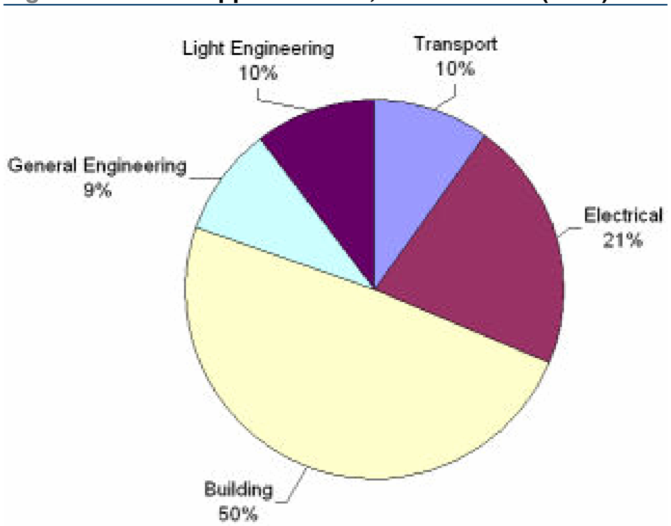
(2) Nearly half of copper demand comes from Europe, Japan and US where all lead indicators are very negative

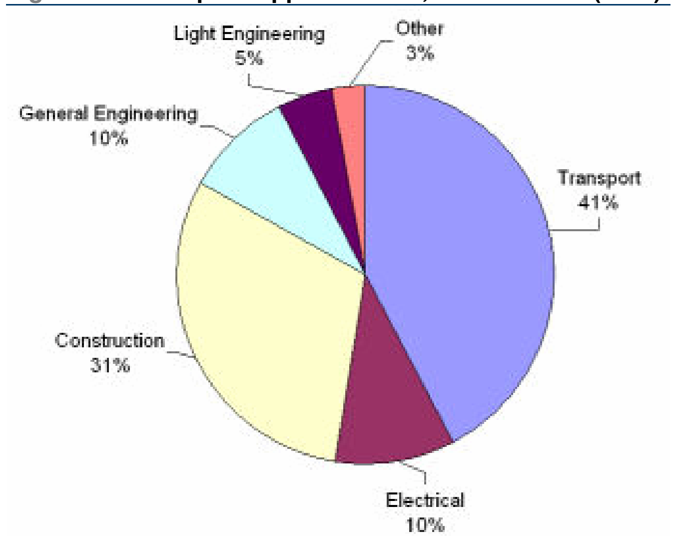
Nearly 15% of global copper demand comes from European and US construction, which is likely to contract by c10% or more.

Figure 368: US: Copper end-use, share of total (2007)



Source: Credit Suisse research

Figure 369: Europe: Copper end-use, share of total (2007)

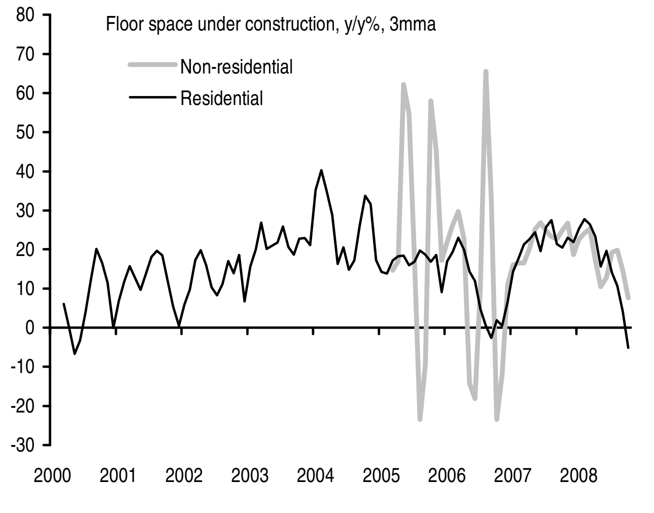


Source: Credit Suisse research

(3) China's investment growth looks set to slow despite infrastructure investment!

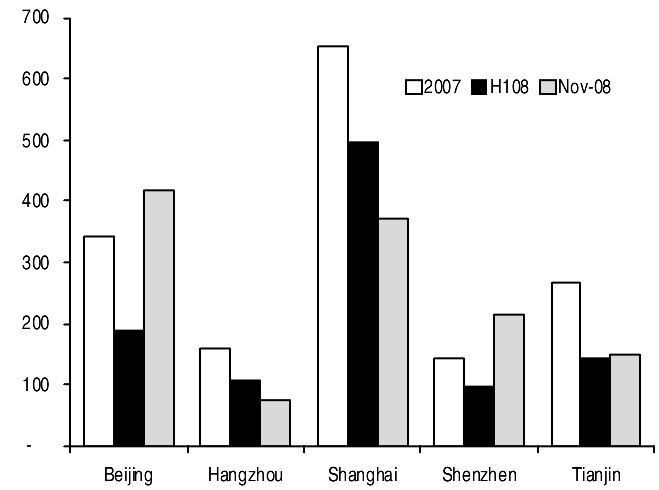
We continue to believe that non-residential construction activity (currently up 8% yoy) will fall to be down around 10% yoy. Residential investment growth is only up 7% yoy yet new homes sales are down 30% yoy.

Figure 370: China's residential and non-residential floor space growth



Source: Credit Suisse China economics and strategy team research

Figure 371: New home sales have dropped sharply in China

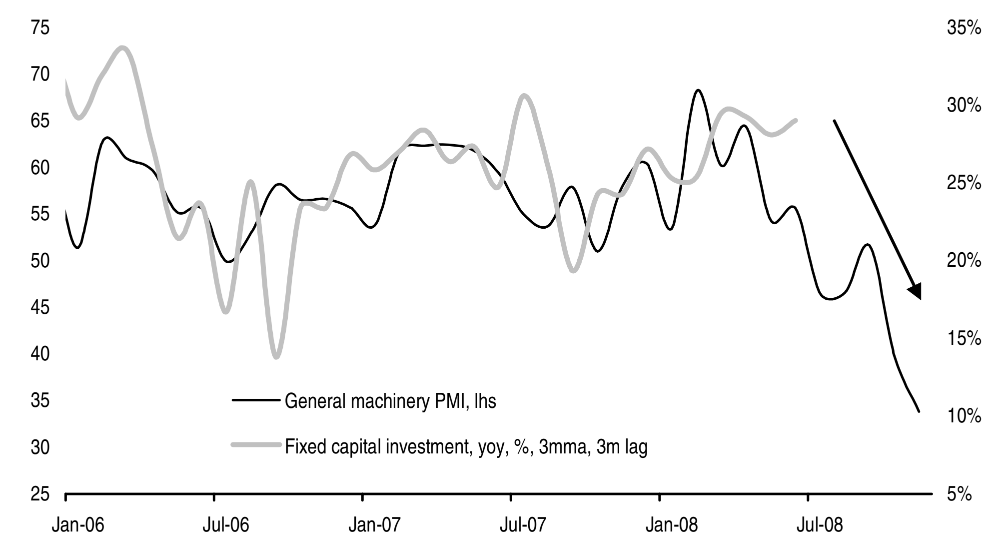


Source: Credit Suisse China economics and strategy team research

The most critical issue, in our view, is that overall investment growth in nominal terms is still running at 24% YoY in China and we think it will slow substantially. We are bullish about China's GDP owing to: (a) its huge policy flexibility as China has FX reserves that are half of GDP, a current account surplus of 8% of GDP that is still rising, FDI of US$100bn, a record budget surplus and government debt to GDP of just 18%; (b) a commitment to create 10m new jobs, which in turn requires around 9% GDP growth; and (c) a 'command' economy that ensures banks will lend if it is the government's will. Hence, we believe that China's GDP will end up in the 8–9% range). However, we believe that, with an investment share of GDP of 41%, investment growth will slow relative to consumption growth. Infrastructure accounts for only 27% of total investment.

The best lead indicator of investment—the machinery PMI—is consistent with investment growth slowing to around 10%.

Figure 372: Sharp drop in China machinery PMI suggests a slowdown in fixed capital investment growth in China



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Electricity output and chemical fertiliser production (a component of the OECD lead indicator for China) have both slumped and indicate a level of GDP way below any published number.

Figure 373: **Electricity output has slumped**

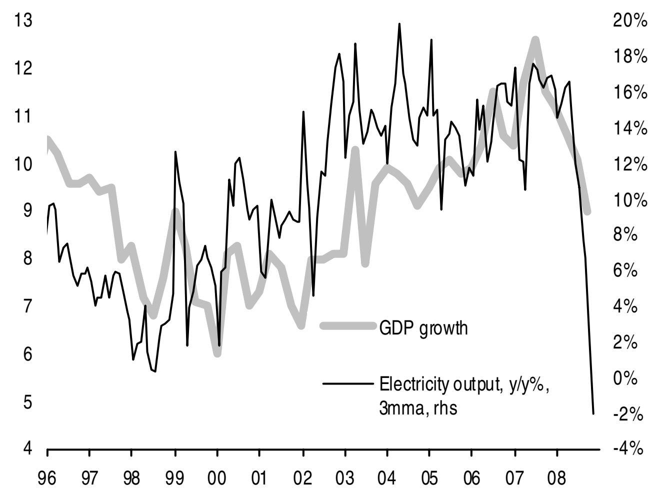

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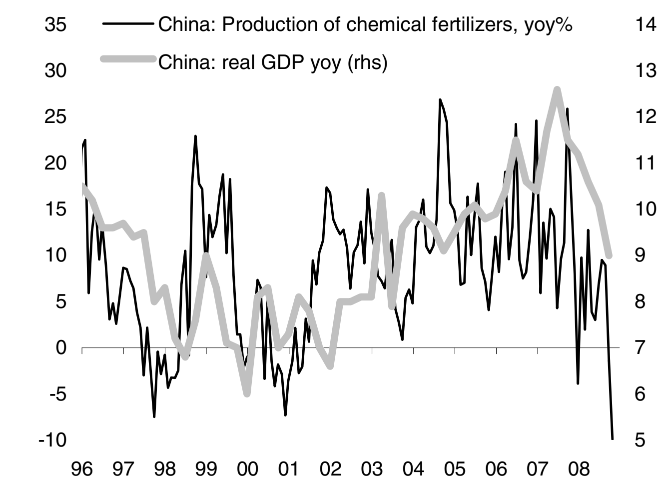
Figure 374: **Production of chemical fertilisers—component of OECD lead indicator—is down 10% yoy**



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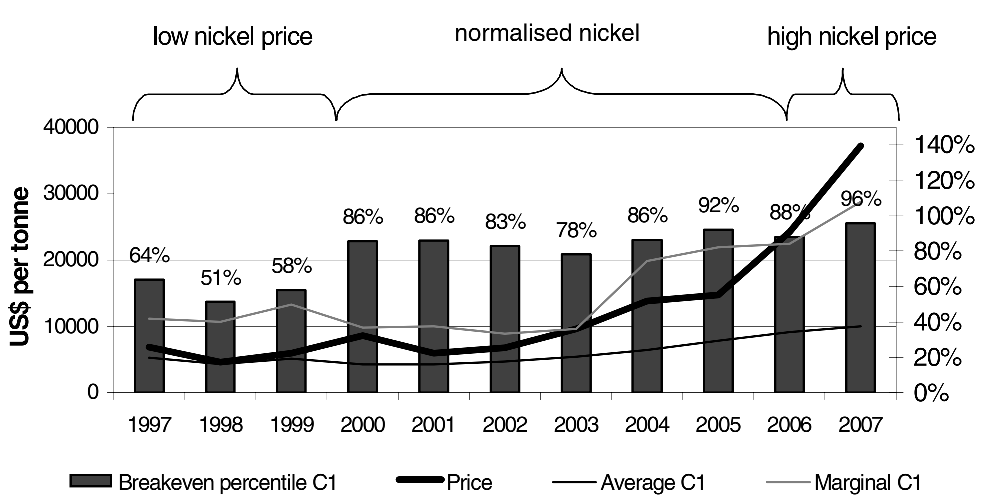
The issue is whether this growth shortfall reflects final end demand or inventory. However, the China PMI inventory numbers are still above the level of 1H 2008. Thus it appears to reflect growth concerns.

(4) Historically, industrial commodity prices trough when around 20–50% of production is below the cash cost

Figure 375 shows that nickel prices in 1998 troughed when nearly half of nickel was below the cash cost.

Figure 375: **Nickel breakeven costs over time**

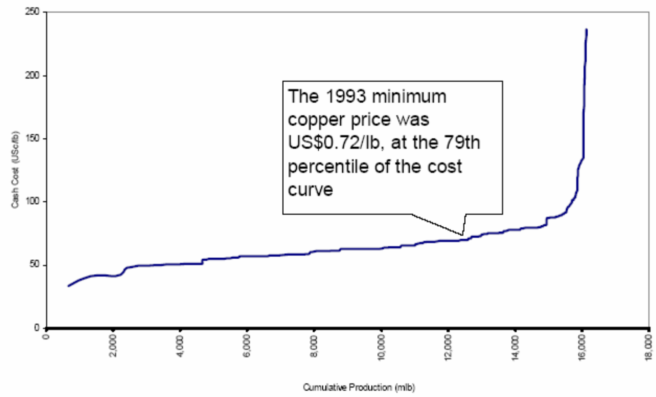


Source: Brook Hunt, Credit Suisse research

We fear that this may need to happen again.

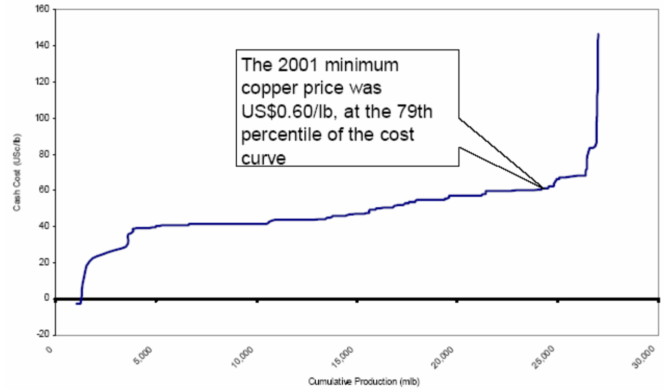
In the last two cycles, copper prices troughed when 20% of production had a cash cost above the spot price.

Figure 376: 1993 copper cash curve



Source: Brook Hunt, Credit Suisse research

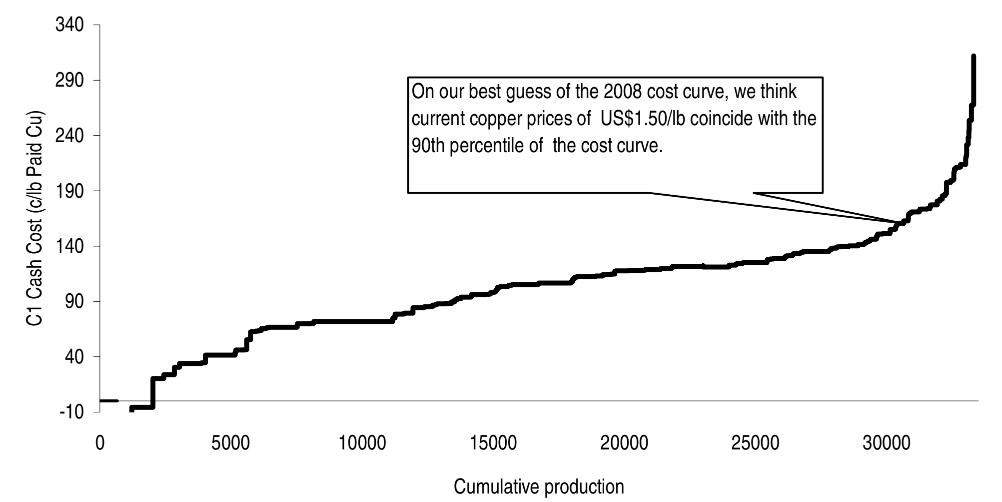
Figure 377: 2001 copper cash curve



Source: Brook Hunt, Credit Suisse research

Currently, only 10% of copper production is operating below the cash cost. We fear that given the nature of this cycle around 40–50% of production needs to be below the cash cost. A copper price of US$1.05/lb would result in 50% of production with a cash cost above the spot price down from the current price of US$1.50.

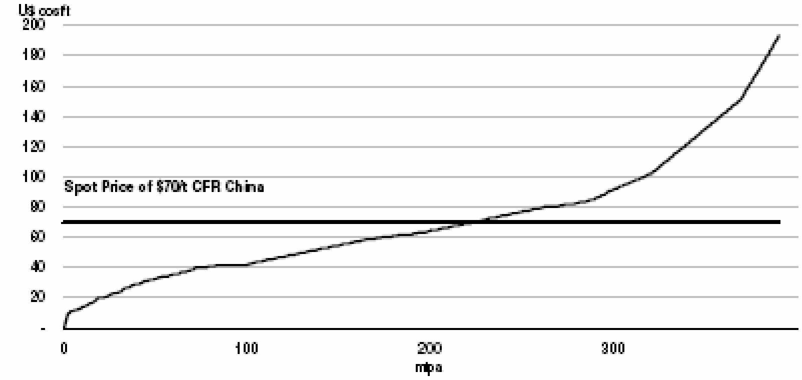
Figure 378: 2008 copper cash curve



Source: Brook Hunt, Credit Suisse research

Current iron ore and coking coal prices appear to be well above cash costs and even if we use the Chinese spot price for iron ore, Credit Suisse's mining team estimates that approximately 20% of iron ore producers are operating at a loss, largely among the higher-cost Chinese and Indian mines (cost curve for Chinese and Indian mines shown in Figure 379).

Figure 379: **Iron ore cost curve—Chinese and Indian iron ore producers**



Source: Rio Tinto, Credit Suisse mining team

The bulk commodities account for 40–50% of earnings at Rio and BHP.

We would also stress that a very sizeable proportion of cash costs are energy related (about a third) and thus cash costs and therefore anticipated troughs in commodity prices will fall.

(5) Mining stocks are not particularly depressed versus industrial commodity prices
Mining stock prices against commodity prices are now back at trend, although the slump in the baltic freight index could suggest further underperformance for the mining stocks. Although the slump in the index may in part be owing to the virtual paralysis of credit markets for shipping companies, it may give a false impression about the potential depth of metal price falls.

Figure 380: **Global mining stocks relative to base metals**

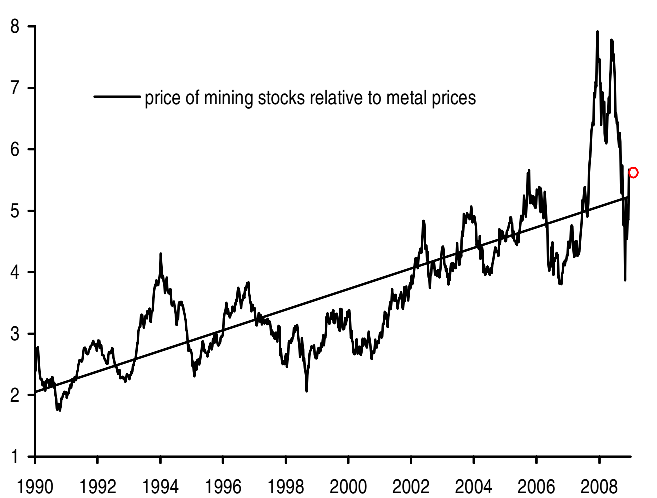


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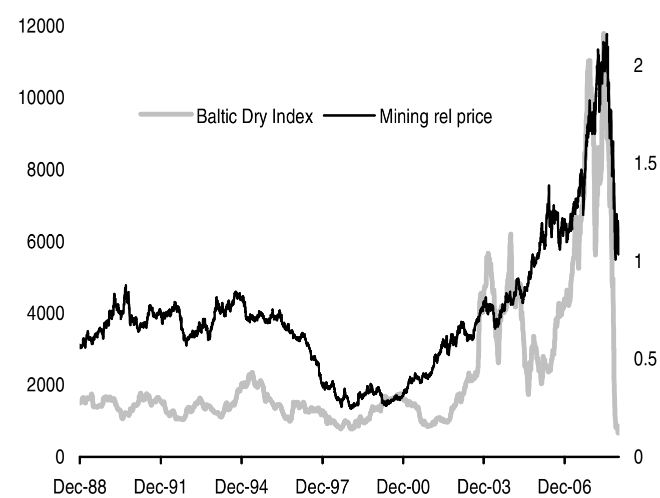
Figure 381: **Global mining stocks price relative versus baltic freight**



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(6) Valuations do not yet look attractive

The sector still looks expensive on P/B relatives. While P/E relatives are close to the lows of the last bear market, once we adjust for more realistic earnings (from Figure 384), then P/E relatives are only middling (with an absolute P/E multiple of 9x).

Figure 382: **Global metals & mining P/B relative to market**

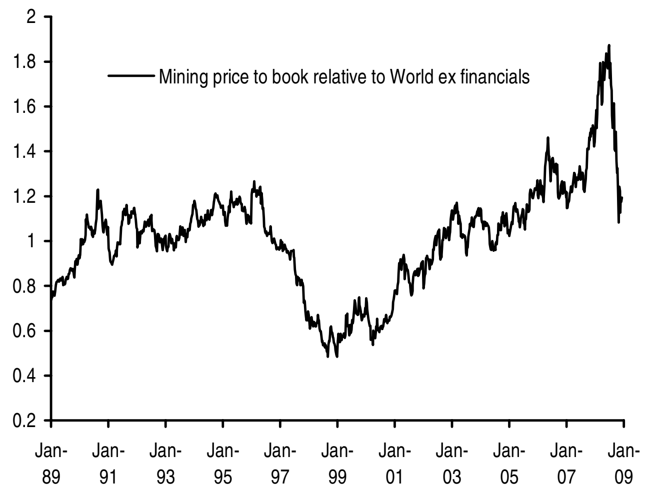

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Figure 383: **P/E relatives are cheap, but earnings still have a long way to fall, in our view**

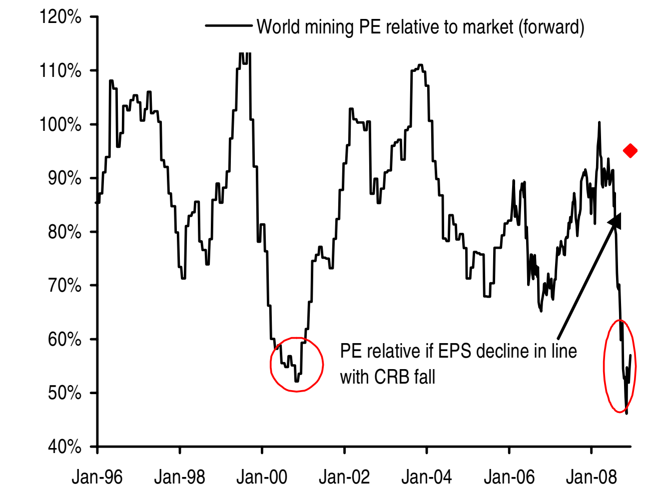

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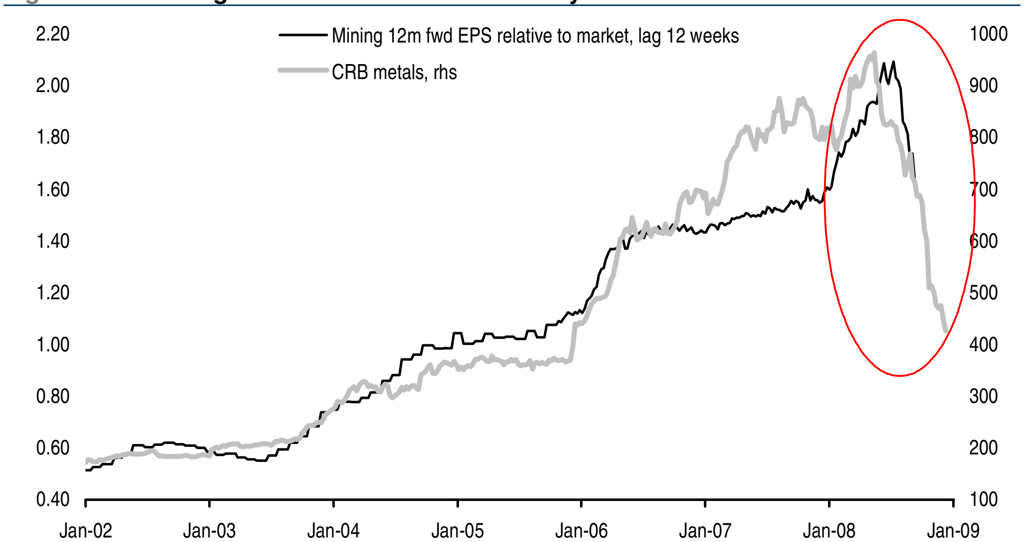
Figure 384: **Earnings have further downside if they continue to follow the CRB index**



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(7) Not fully fledged capitulation!

Sell-side analysts are just beginning to be concerned but they do not appear to be anywhere near capitulation levels. Frank Russell data do not signal abnormal underweights.

Figure 385: **UK metals & mining sector: Analysts are just starting to become less positive on the sector**

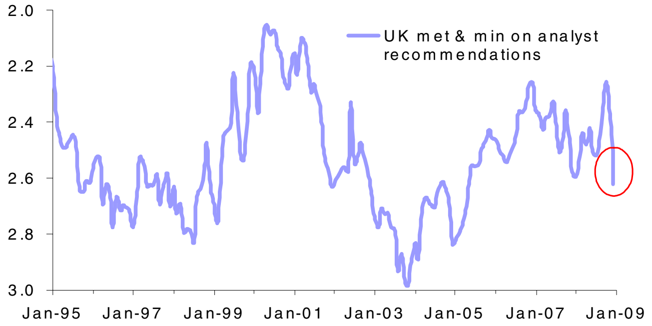

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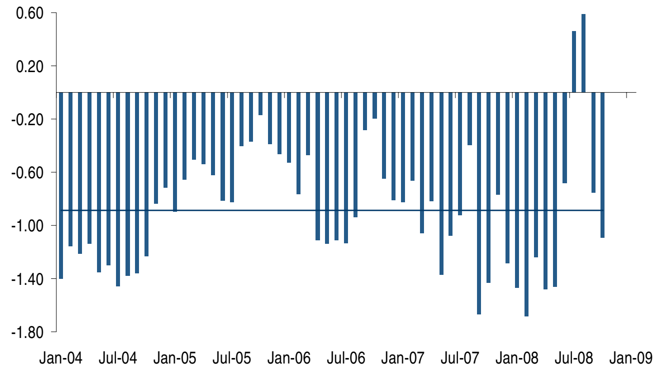
Figure 386: **Frank Russell: European metals & mining weighting relative to benchmark (free-float basis)**



Source: Frank Russell

We are also nervous that ETFs and open futures interest are only back to 2006 levels—hardly capitulation.

Again as highlighted on page 77, it is highly unlikely that the next bull market will have the same leadership as the last bull market.

What are the risks to an underweight position on mining?
(a) It is a cartel, as we can see in Figure 387.

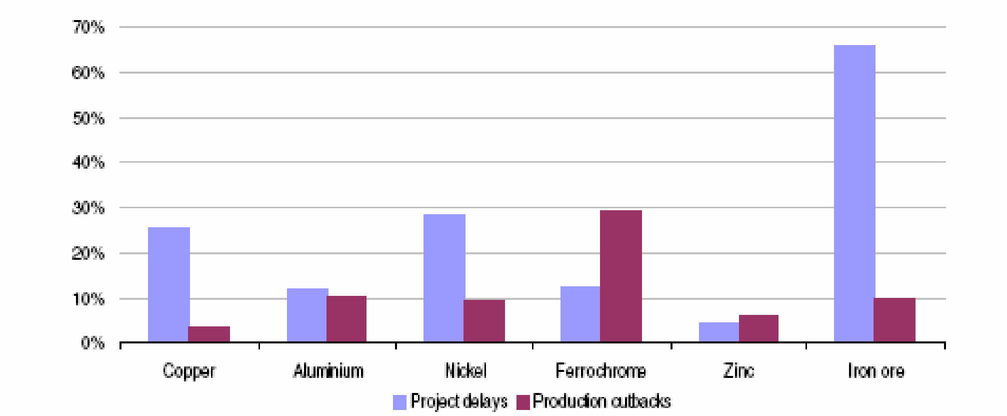
Figure 387: **Concentration of production in selected metals**

	% of capacity accounted for by the top 5 producers
Seaborne iron ore	100
Seaborne coking coal	100
Platinum	94
Nickel	83
Stainless steel	58
Alumina	55
Copper	47
Aluminium	40
Gold	37
Zinc	29

Source: Company data, Credit Suisse Metals and Mining team, latest reported

Projects are being cut aggressively. 65% of global iron ore supply and 25% of global copper supply could be deferred for at least two years. Production cutbacks are approximately 4% for copper and 10% of iron ore.

Figure 388: Project delays, % of global supply

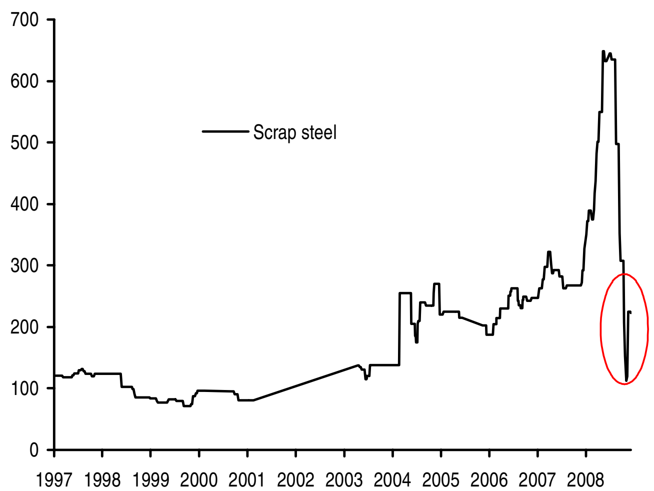


Source: Company data, Credit Suisse Metals and Mining team, latest reported

(b) China might seek to acquire strategic assets.

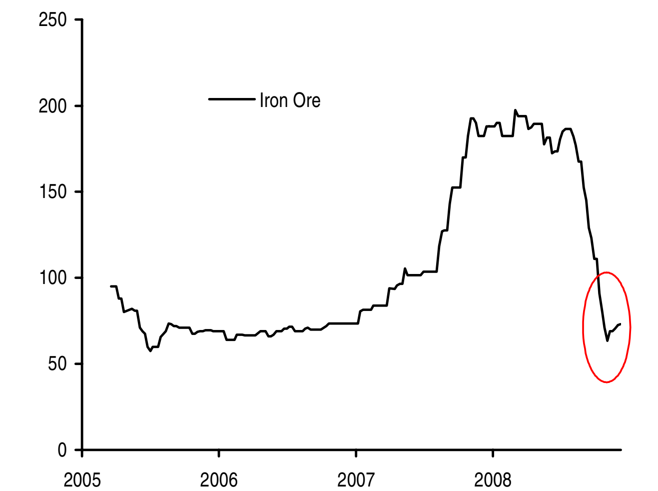
This may be reflected in the recent stabilisation in scrap steel prices and iron ore prices, halting their rapid decline.

Figure 389: Scrap steel prices have risen



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse research

Figure 390: Iron ore prices have risen

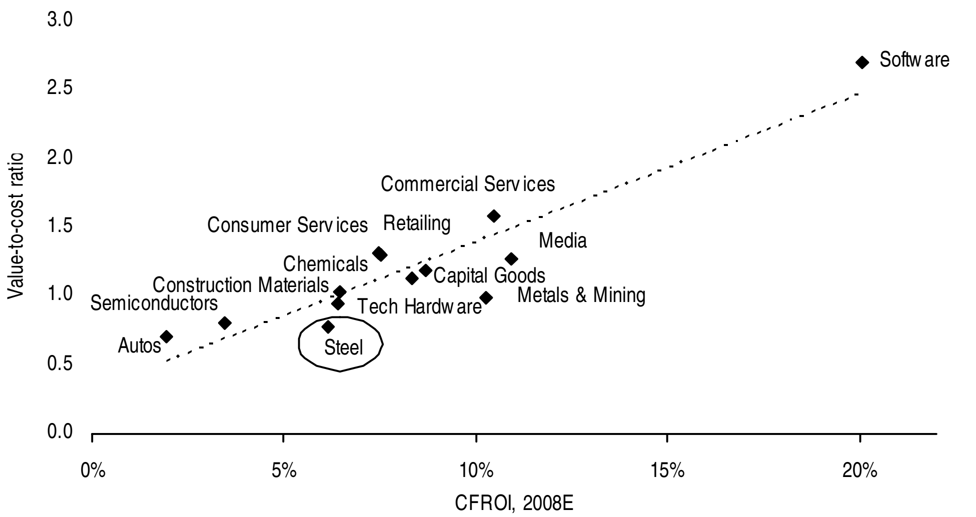


Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse research

We would prefer to play the China story via steel. Why?

It looks attractively valued now on our scatter of CFROI® versus value to cost.

Figure 391: **Global cyclicals on HOLT: CFROI® and value-to-cost**



Source: Credit Suisse HOLT

Already nearly 40% of global steel production is operating on a cash loss basis.

Steel also benefits from the fall in iron ore, coking coal and energy prices (these account for about 50% of input costs).

China must have been de-stocking, in our view. China's steel production is down 13% and steel exports are up 7%. This implies roughly a 20% decline in China's steel demand.

ArcelorMittal has already responded very aggressively to the fall in prices, saying it would authorise production cuts of 15% yoy.

Credit Suisse's European steel analysts' top picks are Thyssenkrupp and Salzgitter.

Figure 392: Steel stocks that look cheap on HOLT with P/B rel market below norm

Name	P/E (12m fwd) Abs	P/E rel to Industry	P/E rel to mkt % above/below average	P/B Abs	P/B rel to mkt % above/below average	Yield (08e) FCY	Yield (08e) DY	HOLT Implied CFROI less 5-year average	HOLT Price, % change to best	Valuation score	Momentum CFROI	Momentum 1m EPS	Momentum 3m EPS	Momentum 3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Tokyo Steel Mfg	n/a	n/a	n/a	0.6	-38%	5.0%	2.2%	-6.4	54.6	6.0	3.3	n/a	n/a	@NA	2.0	-45.5	9.0	Neutral
Thyssenkrupp Ag	5.3	99%	-26%	0.8	-14%	8.6%	7.5%	-4.3	97.2	7.0	-0.4	0.2	0.0	-0.5	0.5	-31.0	8.5	Outperform
Tata Steel Ltd	2.5	48%	-57%	0.5	-63%	13.3%	7.2%	-7.9	338.4	7.0	-3.0	4.2	-12.9	-8.1	0.5	-9.1	8.5	Outperform
Bluescope Steel	5.0	94%	-19%	0.8	-17%	23.3%	14.4%	-13.9	140.7	7.0	2.5	0.0	0.0	0.0	0.5	-20.0	8.5	Restricted
Severstal	1.5	28%	-69%	0.3	-76%	54.1%	22.1%	-29.8	411.1	7.0	2.8	-6.4	-4.2	2.4	1.0	33.3	8.0	NR
Kobe Steel	6.6	123%	-39%	0.8	-34%	7.0%	4.4%	-2.9	81.2	6.0	0.0	-1.7	2.0	-1.0	1.0	-50.0	8.0	Neutral
United States Steel	4.5	84%	-27%	0.7	-40%	49.1%	3.2%	-4.6	53.6	6.0	4.5	0.5	-12.4	-5.7	1.0	-6.7	8.0	Neutral
Mechel Oao	1.7	32%	-70%	0.6	-54%	51.5%	45.8%	-11.8	185.7	7.0	16.4	-2.6	-10.2	-1.5	0.5	0.0	7.5	Neutral
Onesteel	4.0	75%	-39%	0.6	-4%	11.2%	7.8%	-3.7	137.2	7.0	2.9	0.0	0.0	0.0	0.5	7.7	7.5	Outperform
Jfe Holdings Inc	6.0	112%	-15%	1.1	-22%	19.2%	5.0%	-2.8	68.7	6.0	0.3	-2.3	-2.6	-2.8	0.5	-5.9	7.5	Neutral
Nippon Steel Corp	7.3	137%	-64%	1.0	-25%	12.2%	3.5%	-2.1	34.8	5.0	0.5	2.6	5.2	-5.5	1.5	-36.8	7.5	Neutral
Nisshin Steel Co	10.7	201%	-39%	0.4	-42%	13.9%	4.5%	-3.3	121.6	6.0	-1.5	-8.1	-26.9	-4.4	0.0	-100.0	7.0	NR
Daido Steel Co	6.8	127%	-59%	0.6	-30%	12.1%	3.2%	-0.9	44.9	5.0	1.3	-4.4	2.4	-2.2	1.0	-40.0	7.0	Neutral
Ssab(Svenskt Stal)	5.6	106%	-2%	0.6	-22%	30.4%	10.1%	-9.4	60.8	6.0	1.3	-6.0	-5.4	-4.7	0.5	26.3	6.5	Neutral
Hitachi Metals	6.5	123%	-66%	0.9	-20%	7.4%	2.7%	-0.9	25.0	5.0	0.6	-1.5	-9.1	-2.5	0.5	-14.3	6.5	Neutral
Nucor Corp	7.7	144%	-22%	1.6	-7%	17.0%	4.8%	-8.4	33.9	6.0	-1.5	-1.2	-1.2	-5.9	0.0	42.9	6.0	Outperform
Hoganas Ab	6.0	112%	-28%	1.1	-38%	21.0%	8.6%	-3.0	40.5	6.0	-0.3	-11.2	-16.3	-3.8	0.0	42.9	6.0	NR
Outokumpu Oyj	6.8	128%	12%	0.5	-40%	10.4%	9.6%	-3.5	73.4	5.0	-6.0	-30.3	-60.2	-5.9	0.0	4.4	5.0	Neutral
Sims Metal Mgmt	7.7	145%	19%	0.8	-47%	15.2%	10.5%	-8.7	9.0	5.0	-0.3	0.0	0.0	0.0	0.0	0.0	5.0	Outperform

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Factset, Credit Suisse HOLT, Credit Suisse research

We continue to be overweight gold. We can see from Figure 393 that gold has outperformed other commodities. We believe that all fiscal/monetary policy is aimed at avoiding deflation and in due course negative real rates. The Fed will cap any rise in bond yields. Gold is primarily a play on US real rates staying below 2%. Although real rates are likely to rise in 2009 (as inflation turns negative), we expect real rates to return to negative territory in 2010–12. Essentially, in our view, either the Fed prints a lot more money (and that would be good for gold as it would weaken the dollar and help inflation) or we get a financial meltdown—that also helps gold.

Figure 393: Gold has outperformed other metals

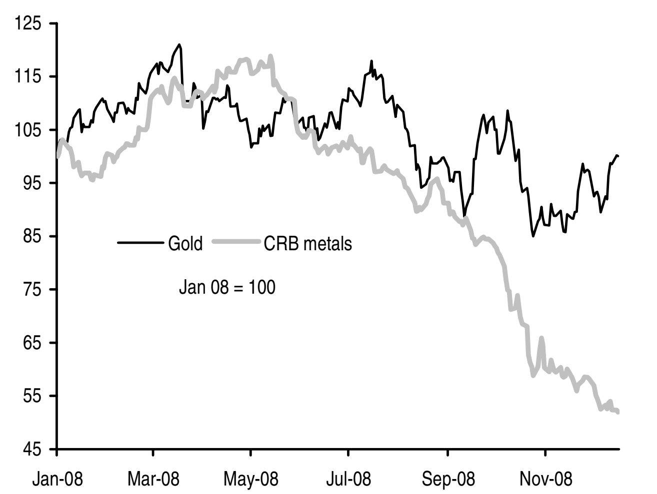


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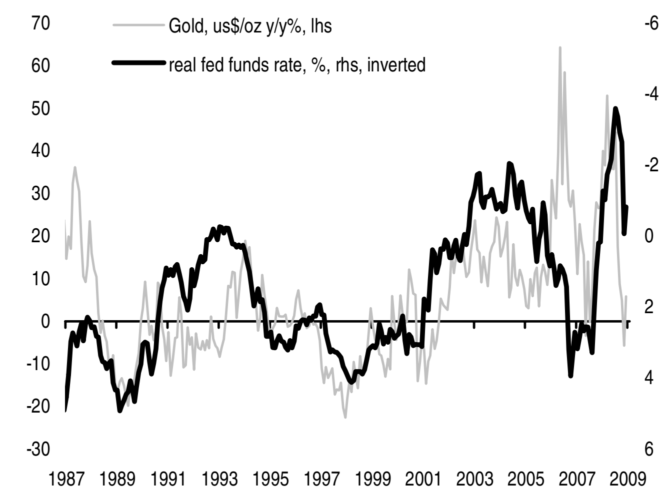
Figure 394: Gold is a play on negative real rates



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Energy utilities: Remain underweight

(1) The price of electricity is very high relative to the price of oil.

The sector has decoupled hugely from the oil price—something that has been very unusual. We can see that the price of power relative to the price of oil is at the top end of its range.

Figure 395: UK & Germany: Electricity prices relative to crude oil

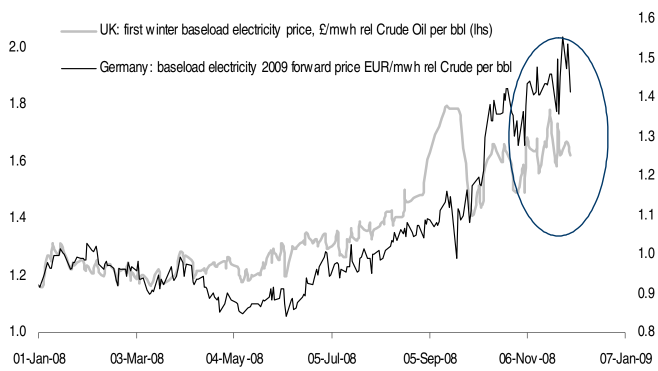

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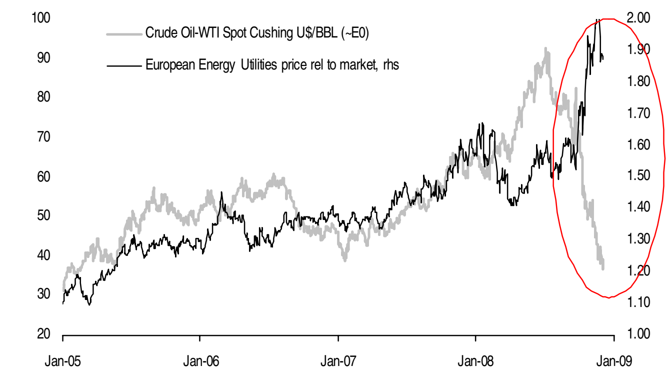
Figure 396: Energy utilities: Price relative versus the oil price



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(2) At the current oil price, the price of power is close to the price of the new entry for CCGT.

Clearly this is not very relevant in the short term but it does imply that in the longer term there is downside potential for the price of power relative to other energy prices.

Figure 397: New entrant costs

New Entry Cost

Oil Price (US $/bbl)	**50.0**	**75.0**	**100.0**
Coal (€/MWH)	73.0	80.0	88.0
Nuclear (€/MWH)	60.0	60.0	60.0
CCGT (Gas) (€/MWH)	62.0	82.0	102.0
Forward Prices (€/MWH)			
2009 EEX baseload (Germany)	56.5	56.5	56.5
CS Long term estimate	61.0	61.0	61.0
Shortfall on forward curve (€/MWH)			
Coal	(16.5)	(23.5)	(31.5)
Nuclear	(3.5)	(3.5)	(3.5)
CCGT (Gas)	(5.5)	(25.5)	(45.5)

Source: Credit Suisse European Utilities team estimates

(3) Energy utilities now look expensive relative to integrated oil

European energy utilities look expensive on P/E and DY relatives to IOCs.

Figure 398: European energy utilities 12m fwd P/E rel to IOCs

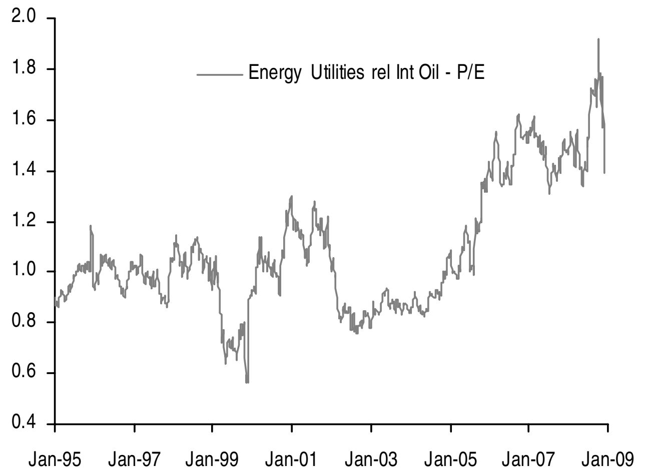

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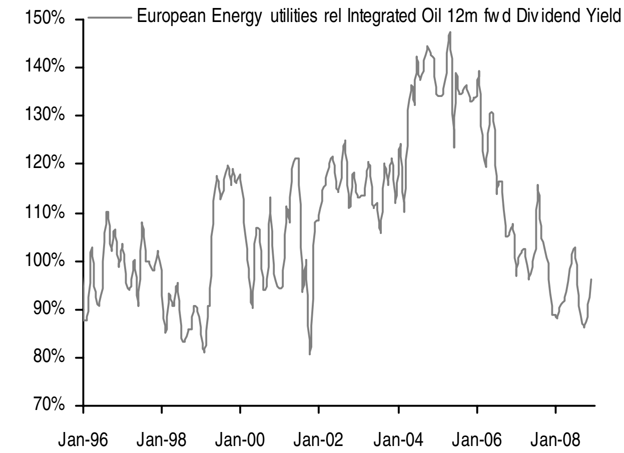
Figure 399: European energy utilities 12m fwd DY rel to IOCs



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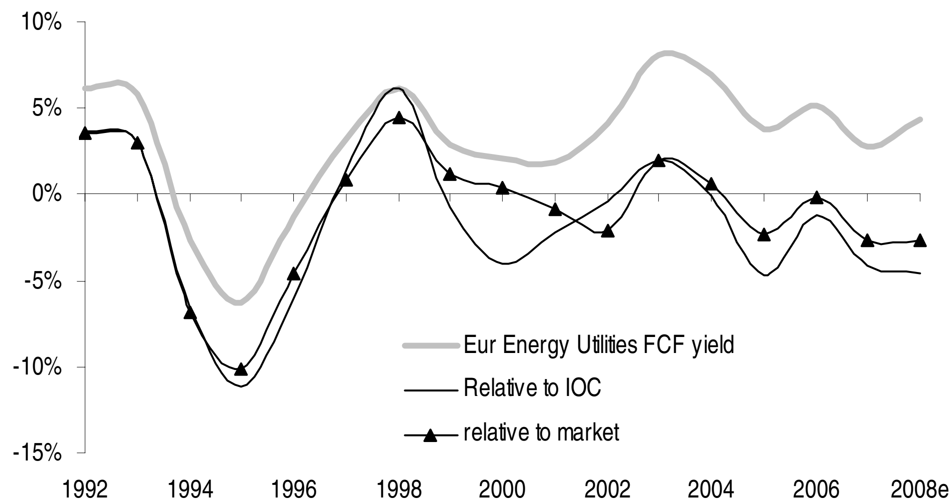
The FCF of energy utilities is now just 4% (2008E).

Figure 400: European energy utilities' FCF yield relative to IOCs and relative to market



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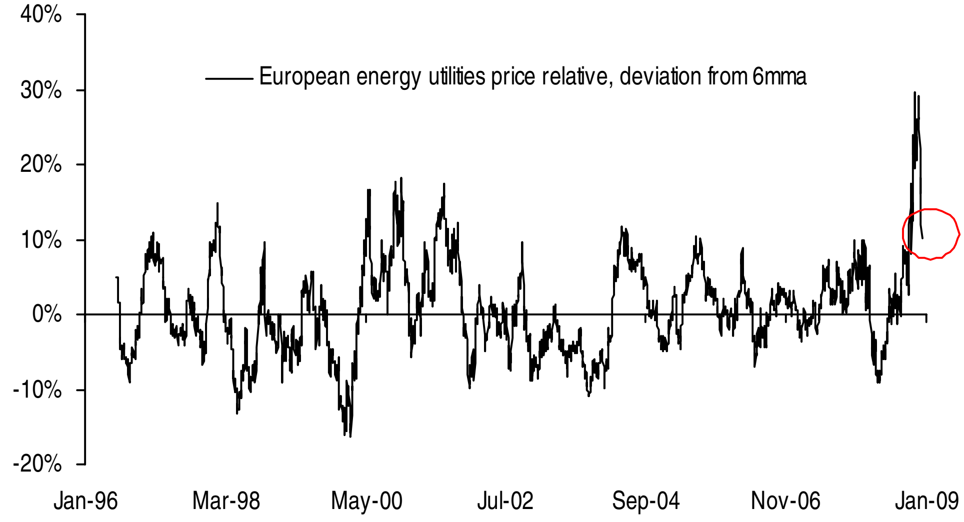
We also note that energy utilities still look overbought on our price momentum monitor.

Figure 401: **European energy utilities on our price momentum monitor**



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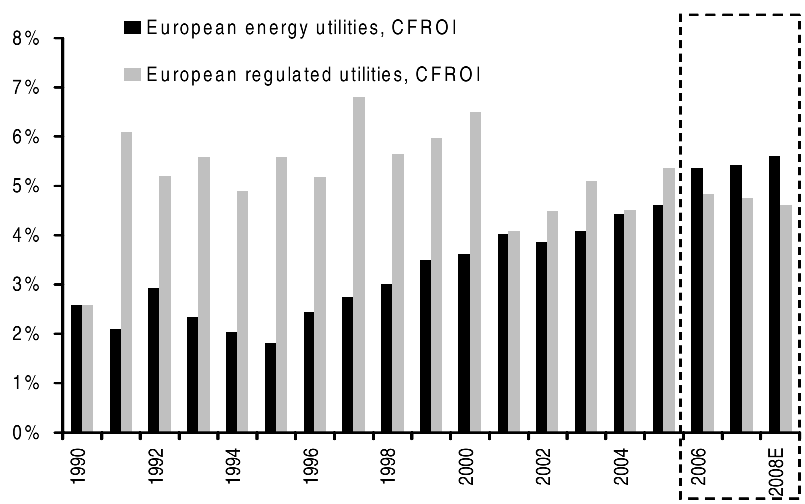
(4) Energy utilities' CFROI® is now above that of regulated utilities, raising the threat of a tighter regulatory environment. Energy utilities make an easy 'victim' for governments whose budget deficits are rising very sharply.

Figure 402: **Cash-flow returns for energy utilities are now above those of regulated utilities**



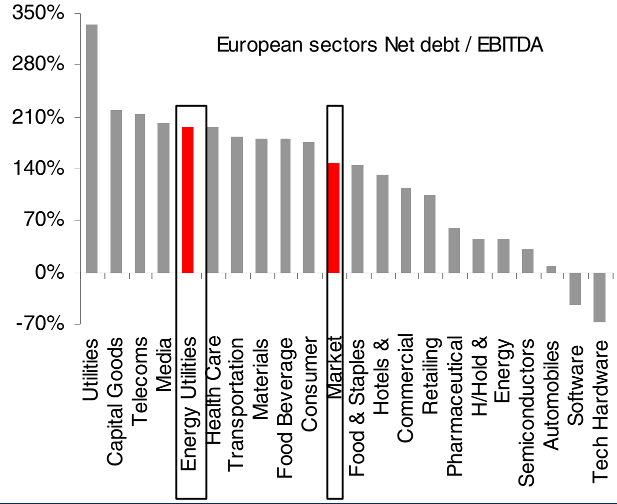
Source: Credit Suisse HOLT, Credit Suisse research

(5) As explained earlier, we are concerned that the oil price could fall to US$30–40.

(6) Not such a safe haven.

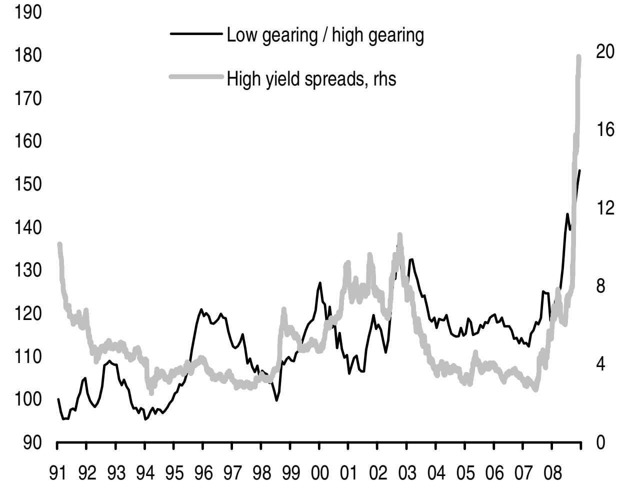
We are also concerned that energy utilities' leverage is marginally higher than the market and FCF is low (4% in 2008E).

Figure 403: **Net debt to EBITDA for European sectors**



Source: Factset, MSCI, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 404: **Low gearing is outperforming high gearing**



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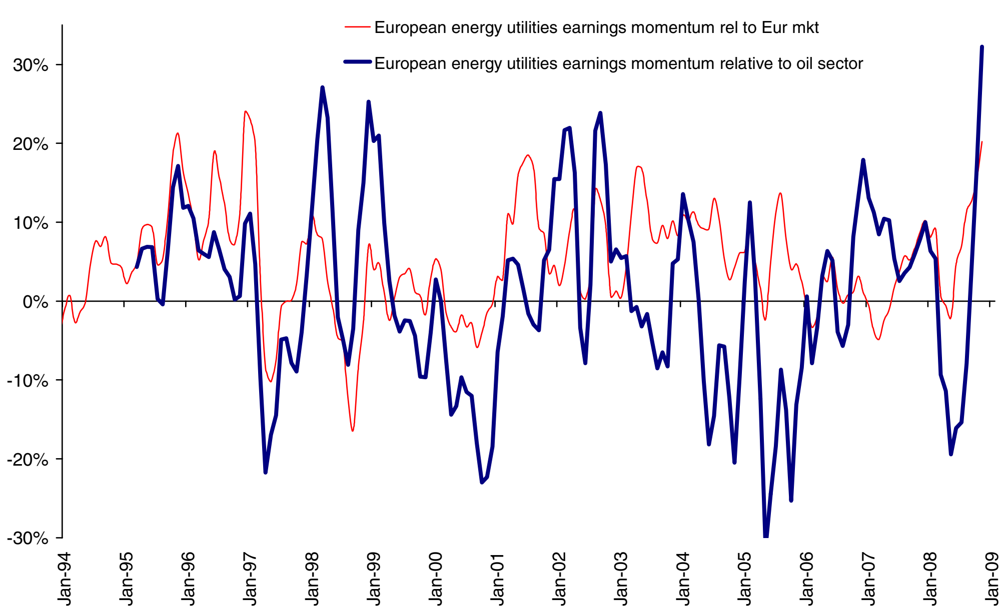
We also note that the earnings momentum of the European energy utilities' sector (both relative to the market and relative to the oil sector) is at the top end of its range—any further improvement is unlikely from here.

Figure 405: **European energy utilities' earnings momentum relative to market and relative to the oil sector**



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We are least positive on Gas Natural, Verbund, Enel.

Figure 406 shows European energy utilities stocks that have a low 2009E FCF yield (we use 2009E leveraged FCF yield based on our analysts' calculations). Note that most of these stocks also look expensive on HOLT.

Figure 406: European Energy utilities that have low 2009e FCF yield (leveraged FCF yield- based on our analysts' calculations) and their valuations

		-----P/E (12m fwd) ------			------ P/B -------				HOLT			-- Momentum ----					
Name	Net Debt as a % of Mcap	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY 2009e (leveraged)	DY 2008e	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Edp Energias Portu	187%	10.3	87%	18%	1.4	58%	-13.2%	5.4%	-0.1	1.3	4.0		-1.2	0.4	1.0	33.3	5.0	Neutral
Veolia Environneme	251%	9.7	96%	-8%	1.2	-37%	-10.5%	7.1%	2.6	-46.9	4.0		-16.8	-1.1	0.0	-53.9	5.0	Neutral
Scot & Sthn Energy	70%	9.2	77%	34%	4.4	145%	-1.0%	6.0%	1.4	-29.3	2.0		0.6	8.3	1.0	-20.0	4.0	Neutral
Union Fenosa Sa	62%	17.0	143%	n/a	3.1	n/a	0.0%	3.5%	6.0	-47.7	0.0		4.5	0.9	2.0	-56.5	3.0	Neutral
Iberdrola Sa	101%	9.6	81%	30%	1.1	25%	1.7%	6.1%	1.1	-4.6	2.0		1.8	1.8	2.0	42.9	4.0	Neutral
Gas Natural Sdg	81%	7.9	60%	-22%	1.4	-19%	2.0%	6.6%	-0.7	19.9	7.0		0.6	2.1	1.5	-41.7	9.5	Underperform
Rwe Ag (Neu)	85%	8.4	83%	-10%	3.0	47%	2.1%	7.6%	1.2	-6.3	4.0		0.4	1.4	2.0	22.2	6.0	Neutral
Fortum Oyj	64%	7.8	66%	0%	1.7	110%	4.2%	7.3%	-1.3	36.3	5.0		2.2	2.2	1.5	0.0	6.5	Neutral
Verbund	36%	11.1	93%	0%	4.3	138%	5.8%	3.7%	5.1	-23.8	2.0		-0.1	1.1	1.0	-33.3	4.0	Underperform

Source: MSCI, I/B/E/S, © Datastream International Limited ALL RIGHTS RESERVED, Factset, Credit Suisse HOLT, Credit Suisse research

Appendix 1:

'Masters of their own destiny'

European stock screens:
We screen for European companies with the following characteristics:

(a) Superior CFROI® both relative to the market and relative to their sector. We screen for stocks with CFROI® greater than the sector in eight out of the past ten years;

(b) Low volatility of CFROI®;

(c) High FCF yield; and

(d) Large cap (in excess of US$5bn).

In Figure 407 we show a list of the European stocks that screen best on these measures.

Figure 407: **European stocks that have superior CFROI® relative to the market, that also have CFROI® greater than the sector in eight out of the past ten years, that have low CFROI® volatility, high FCF yield (>5%) and that are large cap (>US$5bn)**

				-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	S&P Credit Rating	Net Debt as a % of Mcap	CFROI co-eff of variation	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Adidas Ag	n/a	77%	14%	8.1	71%	-8%	1.9	-25%	11.6%	2.2%	-2.6	26.1	6.0	0.7	-0.2	-1.3	-0.2	0.5	0.0	6.5	Outperform
Brit Amer Tobacco	BBB+	24%	23%	12.3	107%	80%	5.7	154%	7.0%	4.7%	11.6	-39.2	1.0	1.6	0.5	1.5	1.2	2.0	80.0	3.0	Outperform
Diageo	A-	32%	22%	13.4	106%	54%	6.9	200%	6.0%	3.7%	15.6	-54.9	2.0	1.8	0.0	0.0	0.0	0.5	-18.5	3.5	Outperform
France Telecom	A-	100%	23%	9.5	92%	14%	1.8	1%	12.1%	7.2%	-0.9	15.9	5.0	0.4	0.3	0.8	0.0	1.5	13.5	6.5	Neutral
Hennes & Mauritz	n/a	9%	18%	16.0	121%	29%	9.5	98%	5.1%	4.9%	8.3	-41.4	2.0	1.5	-0.3	-3.7	-0.4	0.5	-3.0	3.5	Outperform
Imperial Tobacco	BBB	28%	11%	10.5	92%	49%	2.2	-95%	6.6%	4.1%	-25.4	-34.2	4.0	4.4	-0.1	-0.2	-0.2	0.5	57.9	4.5	Outperform
Kuehne&Nagel Intl	n/a	49%	12%	13.4	253%	52%	3.6	-7%	7.8%	5.2%	-1.3	-11.9	4.0	0.7	-1.0	-4.5	0.8	1.0	-5.3	6.0	Neutral
LVMH	A-	67%	13%	10.7	94%	-3%	2.1	-1%	7.1%	3.5%	2.8	-40.3	5.0	0.0	-0.9	-2.0	-0.1	0.5	58.6	5.5	Outperform
Nestle Sa	AA	21%	13%	13.0	101%	38%	3.5	73%	5.8%	3.1%	5.3	-20.6	1.0	1.8	0.9	0.1	-0.1	1.5	16.7	2.5	Outperform
Nokia Oyj	A	-9%	29%	10.7	90%	-6%	3.6	24%	15.4%	4.5%	-3.2	8.2	6.0	0.3	-5.1	-8.2	-3.4	0.5	12.0	6.5	Neutral
Porsche Auto Hl Se	n/a	48%	22%	4.6	17%	-62%	0.9	-65%	15.0%	3.8%	-37.7	145.2	6.0	2.4	-5.2	15.1	-1.3	1.0	41.9	7.0	Outperform
Reckitt Benck Grp	A+	5%	24%	15.4	111%	59%	7.4	127%	5.6%	2.7%	5.5	-40.7	2.0	9.6	0.1	2.6	1.8	2.0	25.0	4.0	Outperform
Reed Elsevier	A-	28%	23%	10.8	101%	9%	13.6	377%	9.0%	4.1%	11.6	-44.0	2.0	7.9	0.6	1.2	5.3	2.0	-6.7	5.0	Outperform
Schneider Electric	A-	55%	14%	8.3	78%	-18%	1.4	24%	14.4%	6.8%	-2.8	23.9	6.0	2.5	-0.4	-0.4	0.5	1.0	-4.8	8.0	Neutral
Shire	n/a	13%	26%	14.5	141%	n/a	7.0	n/a	8.2%	0.7%	-7.4	67.9	4.0	6.0	-2.3	5.2	2.2	1.5	44.4	5.5	NR
Synthes Inc	n/a	-2%	19%	16.7	134%	8%	2.9	-21%	5.4%	0.8%	-0.1	-28.3	3.0	-0.4	0.3	10.6	12.0	1.5	5.9	4.5	Outperform
Thomson-Reuters Pl	n/a	54%	13%	10.9	103%	n/a	1.0	n/a	10.3%	5.0%	0.3	-44.8	3.0	-4.9	2.7	2.6	3.3	1.5	-64.7	5.5	Neutral
Tnt Nv	BBB+	80%	20%	7.6	58%	-2%	3.0	26%	15.2%	5.9%	-0.7	0.9	6.0	0.0	-2.5	-8.9	-0.8	0.5	9.1	6.5	Outperform
Vodafone Group	A-	50%	22%	9.4	79%	-15%	0.9	-75%	12.9%	5.9%	-4.6	10.2	7.0	-1.1	-0.1	0.2	0.2	1.0	9.1	8.0	Neutral

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We add one more criterion:

(e) all of the above plus leverage below peer group average. This means they will be able to out-live their competitors. We show this screen below.

Figure 408: European stocks: all of the above criteria PLUS low leverage compared with sector peers

					-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	S&P Credit Rating	Net Debt as a % of Mcap	Sector leverage	CFROI co-eff of variation	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Brit Amer Tobacco	BBB+	24%	37%	23%	12.3	107%	80%	5.7	154%	7.0%	4.7%	11.6	-39.2	1.0	1.6	0.5	1.5	1.2	2.0	80.0	3.0	Outperform
Diageo	A-	32%	37%	22%	13.4	106%	54%	6.9	200%	6.0%	3.7%	15.6	-54.9	2.0	1.8	0.0	0.0	0.0	0.5	-18.5	3.5	Outperform
H&M	n/a	9%	79%	18%	16.0	121%	29%	9.5	98%	5.1%	4.9%	8.3	-41.4	2.0	1.5	-0.3	-3.7	-0.4	0.5	-3.0	3.5	Outperform
Imperial Tobacco	BBB	28%	37%	11%	10.5	92%	49%	2.2	-95%	6.6%	4.1%	-25.4	-34.2	4.0	4.4	-0.1	-0.2	-0.2	0.5	57.9	4.5	Outperform
Kuehne&Nagel Intl	n/a	49%	158%	12%	13.4	253%	52%	3.6	-7%	7.8%	5.2%	-1.3	-11.9	4.0	0.7	-1.0	-4.5	0.8	1.0	-5.3	6.0	Neutral
LVMH	A-	67%	68%	13%	10.7	94%	-3%	2.1	-1%	7.1%	3.5%	2.8	-40.3	5.0	0.0	-0.9	-2.0	-0.1	0.5	58.6	5.5	Outperform
Nestle Sa	AA	21%	37%	13%	13.0	101%	38%	3.5	73%	5.8%	3.1%	5.3	-20.6	1.0	1.8	0.9	0.1	-0.1	1.5	16.7	2.5	Outperform
Nokia Oyj	A	-9%	-1%	29%	10.7	90%	-6%	3.6	24%	15.4%	4.5%	-3.2	8.2	6.0	0.3	-5.1	-8.2	-3.4	0.5	12.0	6.5	Neutral
Reckitt Benck Grp	A+	5%	14%	24%	15.4	111%	59%	7.4	127%	5.6%	2.7%	5.5	-40.7	2.0	9.6	0.1	2.6	1.8	2.0	25.0	4.0	Outperform
Reed Elsevier	A-	28%	68%	23%	10.8	101%	9%	13.6	377%	9.0%	4.1%	11.6	-44.0	2.0	7.9	0.6	1.2	5.3	2.0	-6.7	5.0	Outperform
Schneider Electric	A-	55%	89%	14%	8.3	78%	-18%	1.4	24%	14.4%	6.8%	-2.8	23.9	6.0	2.5	-0.4	-0.4	0.5	1.0	-4.8	8.0	Neutral
Shire	n/a	13%	15%	26%	14.5	141%	n/a	7.0	n/a	8.2%	0.7%	-7.4	67.9	4.0	6.0	-2.3	5.2	2.2	1.5	44.4	5.5	NR
Synthes Inc	n/a	-2%	40%	19%	16.7	134%	8%	2.9	-21%	5.4%	0.8%	-0.1	-28.3	3.0	-0.4	0.3	10.6	12.0	1.5	5.9	4.5	Outperform
Thomson-Reuters	n/a	54%	68%	13%	10.9	103%	n/a	1.0	n/a	10.3%	5.0%	0.3	-44.8	3.0	-4.9	2.7	2.6	3.3	1.5	-64.7	5.5	Neutral
Tnt Nv	BBB+	80%	158%	20%	7.6	58%	-2%	3.0	26%	15.2%	5.9%	-0.7	0.9	6.0	0.0	-2.5	-8.9	-0.8	0.5	9.1	6.5	Outperform
Vodafone Group	A-	50%	89%	22%	9.4	79%	-15%	0.9	-75%	12.9%	5.9%	-4.6	10.2	7.0	-1.1	-0.1	0.2	0.2	1.0	9.1	8.0	Neutral

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

US stock screen— Masters of their destiny

What does this mean? We screen for US companies with the following characteristics:

(a) superior CFROI® both relative to the market and relative to their sector. We screen for stocks with CFROI® greater than the sector in eight out of the past ten years;

(b) low volatility of CFROI®;

(c) high FCF yield; and

(d) large cap (in excess of US$5bn)

We show a list of companies that screen well on these measures in the US.

Figure 409: US stocks that have superior CFROI® relative to the market, that also have CFROI® greater than the sector in eight out of the past ten years, that have low CFROI® volatility, high FCF yield (>5%) and that are large cap (>US$5bn)

			-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			----------- Momentum -------------							
Name	S&P Credit Rating	CFROI co-eff of variation	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Altria Group Inc	BBB+	8%	8.2	72%	16%	7.4	131%	10.9%	8.1%	-6.4	24.4	5.0	-1.7	0.0	-0.5	0.9	0.5	50.0	5.5	Outperform
Vf Corp	A-	8%	9.0	78%	22%	1.5	8%	10.5%	4.3%	-1.8	9.0	5.0	0.1	0.0	-3.2	-1.7	0.5	20.0	5.5	Outperform
Kraft Foods Inc	A-	10%	13.3	103%	27%	1.5	28%	6.0%	4.2%	7.4	-57.6	2.0	-0.2	-0.1	-1.0	-1.8	0.0	-29.4	3.0	Neutral
Lorillard Inc	n/a	10%	11.1	97%	n/a	14.5	n/a	8.0%	5.4%	-6.3	-13.0	6.0	2.4	0.8	0.4	-3.1	1.5	100.0	7.5	Outperform
Conagra Foods Inc	BBB+	11%	9.2	71%	-5%	1.3	-37%	7.3%	5.5%	2.4	-23.8	5.0	-0.7	-2.2	-3.8	2.4	0.5	-80.0	6.5	Neutral
Kellogg Co	BBB+	14%	13.2	102%	17%	6.1	7%	6.3%	3.1%	0.8	-29.3	1.0	-1.1	-0.1	0.4	-0.5	0.5	44.4	1.5	Outperform
Zimmer Holdings Inc	A-	12%	9.0	72%	-41%	1.5	-63%	8.7%	0.0%	-12.7	48.6	6.0	-4.1	0.0	-0.7	-1.4	0.0	-60.0	7.0	Neutral
Heinz (H J) Co	BBB	12%	12.1	93%	23%	5.6	55%	7.6%	4.7%	8.1	-46.9	3.0	1.5	-0.3	-0.7	-4.2	0.5	16.7	3.5	Outperform
Coca-Cola Co	A+	10%	13.6	107%	-8%	4.4	-42%	6.1%	3.4%	6.4	-30.5	3.0	-0.2	0.1	1.1	-2.9	1.0	50.0	4.0	Neutral
Stryker Corp	A+	11%	12.0	97%	-26%	2.8	-40%	7.0%	n/a	-2.5	0.1	6.0	0.2	-0.1	-0.1	-1.0	0.5	4.4	6.5	Neutral
L-3 Communications	BBB-	12%	9.2	110%	-16%	1.4	13%	12.3%	1.7%	-8.7	64.1	4.0	-0.6	0.1	1.8	-0.7	1.0	-20.0	6.0	Neutral
Medtronic Inc	AA-	15%	9.8	79%	-34%	2.8	-35%	9.6%	2.3%	0.4	-8.0	5.0	1.5	-2.1	-2.3	-3.3	0.5	30.8	5.5	Neutral
Johnson & Johnson	AAA	8%	12.4	120%	10%	3.5	-7%	7.6%	3.2%	-7.5	20.7	4.0	-2.5	0.0	0.5	-0.5	0.5	26.3	4.5	Neutral
Air Products & Chemicals	A	14%	10.3	117%	5%	2.0	21%	7.4%	3.0%	2.4	-12.7	1.0	1.3	0.0	-3.0	-0.8	0.5	33.3	1.5	Outperform
Omnicom Group	A-	8%	8.9	84%	-16%	2.3	-26%	11.5%	2.3%	2.1	-15.9	4.0	5.2	-0.2	-3.2	-3.1	0.5	-20.0	5.5	Neutral
Mattel Inc	BBB-	11%	9.8	81%	9%	2.3	-18%	9.1%	5.4%	-0.3	-3.0	5.0	-2.5	-1.6	-9.0	-1.2	0.0	0.0	5.0	Outperform
Jacobs Engineering	n/a	12%	13.4	141%	22%	2.8	16%	6.7%	0.0%	0.6	-4.8	1.0	2.7	0.0	0.5	0.0	1.0	33.3	2.0	Outperform
Pfizer Inc	AAA	12%	6.6	64%	-41%	1.7	-52%	14.2%	7.8%	-6.1	25.1	7.0	-1.3	0.1	0.4	-0.1	1.0	0.0	8.0	Neutral
Amgen Inc	A+	15%	12.4	73%	-17%	3.1	-40%	6.9%	0.0%	-6.5	1.7	6.0	-4.0	0.1	4.0	1.5	1.5	44.0	7.5	Outperform
Staples Inc	BBB	12%	12.0	91%	-18%	2.0	-13%	7.3%	1.9%	1.2	-19.0	4.0	1.3	-1.0	-5.3	-1.2	0.5	41.2	4.5	Outperform
Public Service Entrp Grp	BBB	14%	9.1	91%	27%	1.9	75%	6.2%	4.7%	-1.2	3.0	4.0	0.6	0.0	-1.5	-1.0	0.5	0.0	4.5	Outperform
Ppg Industries Inc	A-	11%	9.0	103%	10%	1.6	-16%	12.3%	4.7%	-0.1	15.4	5.0	1.0	-2.6	-7.4	-0.1	0.5	-23.1	6.5	Neutral
Best Buy Co Inc	BBB-	8%	10.3	77%	-4%	2.1	-30%	8.1%	2.2%	-0.6	-39.6	5.0	-4.5	-17.0	-23.5	0.0	0.0	-33.3	6.0	Outperform

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

We add one more criterion:
(e) leverage below peer group average.

Figure 410: US stocks: All of the above criteria PLUS low leverage compared with sector peers

Name	S&P Credit Rating	Net Debt as a % of Mcap	CFROI co-eff of variation	----P/E (12m fwd) ----- Abs	rel to Industry	rel to mkt % above/below average	----- P/B ----- Abs	rel to mkt % above/below average	Yield (08e) FCY	DY	HOLT Implied CFROI less 5-year average	Price, % change to best	Valuation score	---------- Momentum ---------- CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Altria Group Inc	BBB+	16%	8%	8.2	72%	16%	7.4	131%	10.9%	8.1%	-6.4	24.4	5.0	-1.7	0.0	-0.5	0.9	0.5	50.0	5.5	Outperform
Vf Corp	A-	36%	8%	9.0	78%	22%	1.5	8%	10.5%	4.3%	-1.8	9.0	5.0	0.1	0.0	-3.2	-1.7	0.5	20.0	5.5	Outperform
Lorillard Inc	n/a	-5%	10%	11.1	97%	n/a	14.5	n/a	8.0%	5.4%	-6.3	-13.0	6.0	2.4	0.8	0.4	-3.1	1.5	100.0	7.5	Outperform
Zimmer Holdings Inc	A-	2%	12%	9.0	72%	-41%	1.5	-63%	8.7%	0.0%	-12.7	48.6	6.0	-4.1	0.0	-0.7	-1.4	0.0	-60.0	7.0	Neutral
Coca-Cola Co	A+	4%	10%	13.6	107%	-8%	4.4	-42%	6.1%	3.4%	6.4	-30.5	3.0	-0.2	0.1	1.1	-2.9	1.0	50.0	4.0	Neutral
Stryker Corp	A+	-7%	11%	12.0	97%	-26%	2.8	-40%	7.0%	n/a	-2.5	0.1	6.0	0.2	-0.1	-0.1	-1.0	0.5	4.4	6.5	Neutral
Medtronic Inc	AA-	19%	15%	9.8	79%	-34%	2.8	-35%	9.6%	2.3%	0.4	-8.0	5.0	1.5	-2.1	-2.3	-3.3	0.5	30.8	5.5	Neutral
Johnson & Johnson	AAA	7%	8%	12.4	120%	10%	3.5	-7%	7.6%	3.2%	-7.5	20.7	4.0	-2.5	0.0	0.5	-0.5	0.5	26.3	4.5	Neutral
Air Products & Chemicals	A	55%	14%	10.3	117%	5%	2.0	21%	7.4%	3.0%	2.4	-12.7	1.0	1.3	0.0	-3.0	-0.8	0.5	33.3	1.5	Outperform
Omnicom Group	A-	66%	8%	8.9	84%	-16%	2.3	-26%	11.5%	2.3%	2.1	-15.9	4.0	5.2	-0.2	-3.2	-3.1	0.5	-20.0	5.5	Neutral
Mattel Inc	BBB-	17%	11%	9.8	81%	9%	2.3	-18%	9.1%	5.4%	-0.3	-3.0	5.0	-2.5	-1.6	-9.0	-1.2	0.0	0.0	5.0	Outperform
Jacobs Engineering Group	n/a	8%	12%	13.4	141%	22%	2.8	16%	6.7%	0.0%	0.6	-4.8	1.0	2.7	0.0	0.5	0.0	1.0	33.3	2.0	Outperform
Pfizer Inc	AAA	4%	12%	6.6	64%	-41%	1.7	-52%	14.2%	7.8%	-6.1	25.1	7.0	-1.3	0.1	0.4	-0.1	1.0	0.0	8.0	Neutral
Amgen Inc	A+	6%	15%	12.4	73%	-17%	3.1	-40%	6.9%	0.0%	-6.5	1.7	6.0	-4.0	0.1	4.0	1.5	1.5	44.0	7.5	Outperform
Staples Inc	BBB	59%	12%	12.0	91%	-18%	2.0	-13%	7.3%	1.9%	1.2	-19.0	4.0	1.3	-1.0	-5.3	-1.2	0.5	41.2	4.5	Outperform
Public Service Entrp Grp Inc	BBB	74%	14%	9.1	91%	27%	1.9	75%	6.2%	4.7%	-1.2	3.0	4.0	0.6	0.0	-1.5	-1.0	0.5	0.0	4.5	Outperform

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Appendix 2

Companies with superior structural sales growth in their sector—the analysts' view

We surveyed our analysts in Europe, the US and Asia to find out which stocks in their sector they consider to have superior structural sales growth. We show the best-positioned companies in the figures below.

European stocks that Credit Suisse analysts believe have superior structural sales growth in their sector

Figure 411: European stocks that have superior structural sales growth in their sector (according to our analysts)

Stock	Analyst Comment	CS Rating
Kingspan	One product area that still has a structural growth story above the basic product lines are energy efficient products - the most significant of which will be insulation. Not a near term theme but over the longer term our analysts believe that building regulations will get increasingly more stringent with regard to energy efficiency and thus this product area will outgrow the sector average on a 5-10 year view. The pure play on this theme is in building construction sector is Kingspan	Neutral
Rexam	Relative to its competitors (Ball and Crown) Rexam has superior sales growth considering a much larger share of business in growth markets for beverage cans. Ball and Crown has a larger share of its business is the declining North American market, while Rexam has a 65% market share in fast growing Latam markets and 45% market share in Europe - both markets growing at high single digit rates in 2008 measured in volume - higher growth including price effects	Outperform
BAT	due to superior emerging market exposure (>50% of profits)	Outperform
Richemont		Outperform
LVMH	Most exposed names to emerging markets, Richemont and LVMH (along with Swatch). In long term, watches and jewellery tend to grow faster than other categories (so Richemont and Swatch well positioned), but note they are more discretionary than e.g. champagne (so have higher beta with market vs the likes of LVMH)	Outperform
Swatch		Outperform
Tesco		Outperform
Metro	Tesco and so far Metro have superior structural sales growth. But capex cut could jeopardise future growth (capex=new space=future growth). NB: Carrefour was also improving in the recent years.	Neutral
Reed Elsevier	Professional Publishers have been growing revenues organically by c.6% on a normalised basis, due to zero/minimal negative impact from declining traditional media whilst exploiting adjacent market growth internationally, through workflow solutions and through added functionality. Moneysupermarket.com, though it is dependent on the credit environment. Our media team highlights: Reed Elsevier, Pearson, Moneysupermarket.com as having superior structural sales growth in their sector	Outperform
Pearson		Neutral
Moneysupermarket.com		Outperform
Philips	Philips has demographic growth drivers in healthcare and lighting. This should make its long-term growth higher than the sector	Outperform
Vedanta Resources	Vedanta has the best structural sales growth for the next 3 years in the sector. Our mining analysts expect other miners to freeze their growth capex spend	Underperform
Syngenta	In the European chemicals sector as a whole Syngenta has the strongest growth fundamentals (driven by ag exposure)	Outperform
Linde		Outperform
Air Liquide	Industrial gases players -Linde and Air Liquide- also have locked-in growth through robust contracts	Neutral
Koninklijke DSM	Among the European specialties sub-sector DSM would be the strongest (has food/nutrition and pharma), but still ranks some way behind Syngenta and the gases	Outperform
Bucher Industries	Bucher Industries - agricultural industry and glass container manufacturing- has superior structural sales in its sector	Outperform
Geberit	Geberit - sanitary technology in Europe- has superior structural sales in its sector	Neutral
KABA	Kaba - security applications- has superior structural sales in its sector	Outperform
Komax	Komax - wire processing machines-has superior structural sales in its sector	Neutral
Sulzer	Sulzer - pre-engineered pumps for the oil and gas industry-has superior structural sales in its sector	Neutral
E.ON	Organic capex programme in mainly greenfield projects should drive superior volume growth for GDF Suez and E.ON	Outperform
GDF Suez	Superior sales growth driven by capex programme (itself supported by strong balance sheet)	Outperform
Renault	Structurally any sales growth in autos will have to come from emerging markets. In theory that leaves Renault and VW best placed, with VW also benefitting from the expansion of its Audi brand globally. However emerging market exposure is a key negative risk for Renault currentlly, as it has added capacity probably 2-3 years ahead of demand	Underperform
Volkswagen		Underperform
BorgWarner, Inc.		Outperform
Denso Corp	For suppliers fuel efficiency should drive structural growth, meaning BorgWarner, Denso, Continental, Elringklinger have superior structural sales growth in their sector	Neutral
Continental		Neutral
Michelin	Tyre makers are well positioned to benefit from the rapid expansion of the global vehicle fleet over the past few years, and ongoing mobilisation of emerging markets. Michelin, Nokian, Pirelli are best placed, in our analysts' view	Outperform
SAP	The best structural growth story within software sector is for SAP. Market-leading product, established positive NPV generator, superior to Oracle's offering, and operates in a duopoly. SAP should gain share in a declining market. Autonomy is another vendor that has an exceptional product, way ahead of competition and an under penetrated market.	Outperform
Accenture Ltd.	Offshore vendors have a superior growth rate because of the cost advantage. Accenture is the only company in its sector where the brand equity generates a solid advantage	Outperform
Capgemini	Amongst European vendors, Capgemini probably has a small edge, according to our analysts	Outperform

Source: Credit Suisse estimates

Of these European stocks, we screen for those companies that also look cheap on HOLT and are trading on a P/B relative below their historical norm. We would highlight Philips, which is Outperform rated.

Figure 412: European stocks that have superior structural sales growth in their sector, that look cheap on HOLT and are trading on a P/B relative below their historic norm

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------								
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Kingspan Group	7.6	73%	12%	0.9	-69%	-0.8%	6.6%	-12.1	23.5	5.0	-7.7	-8.4	-11.8	-0.9	0.0	-55.6	6.0	Neutral
Philips Elec(Kon)	10.5	109%	22%	0.8	-10%	13.0%	4.5%	2.9	6.5	3.0	2.7	-7.4	-13.0	-3.6	0.5	-13.5	4.5	Outperform
Koninklijke Dsm Nv	5.5	62%	-1%	0.5	-15%	25.8%	7.7%	-6.0	92.1	7.0	0.9	1.2	4.3	0.3	2.0	-15.8	10.0	Outperform
Denso Corp	11.2	120%	-27%	0.6	-47%	2.9%	3.7%	-7.3	101.3	5.0	-2.4	-23.8	-41.3	-8.0	0.0	-62.5	6.0	Neutral

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

US stocks that Credit Suisse analysts believe have superior structural sales growth in their sector

In Figure 413 we show a screen of US stocks that our US analysts identified as having superior structural sales growth in their sector and that also look attractive on HOLT and on P/B relative to their historical norm. This highlights Weatherford, National Oilwell Varco, Polo Ralph Lauren, Amphenol, Nucor and Xto Energy, all of which are Outperform rated.

Figure 413: US stocks that have superior structural sales growth in their sector, that look cheap on HOLT and are trading on a P/B relative below their historical norm

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------								
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Weatherford Intl Ltd	4.9	86%	-52%	0.8	-46%	0.5%	0.0%	-6.6	110.3	5.0	-1.4	-0.2	-4.6	-1.3	0.0	56.5	5.0	Outperform
National Oilwell Varco Inc	4.7	82%	-56%	0.8	-52%	22.3%	n/a	-10.1	272.5	7.0	10.6	0.2	-0.2	-0.6	1.0	68.4	8.0	Outperform
Polo Ralph Lauren Cp -	11.0	96%	18%	1.8	-7%	8.0%	0.5%	-2.2	7.8	5.0	0.1	0.0	-0.9	-1.4	0.5	-53.9	6.5	Outperform
Amphenol Corp	10.2	n/a	1%	2.6	-33%	10.1%	0.4%	-8.2	35.8	6.0	0.8	-2.5	-2.9	-1.9	0.5	27.3	6.5	Outperform
Nucor Corp	7.7	144%	-22%	1.6	-7%	17.0%	4.8%	-8.4	33.9	6.0	-1.5	-1.2	-1.2	-5.9	0.0	42.9	6.0	Outperform
Xto Energy Inc	8.2	93%	-18%	1.3	-39%	-49.9%	1.3%	-6.1	27.0	5.0	-4.0	-2.1	-10.8	-3.7	0.0	51.7	5.0	Outperform

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Asian stocks that Credit Suisse analysts believe have superior structural sales growth in their sector

In Figure 414 we show the Asian stocks that our analysts identified as having superior structural sales growth in their sector.

Figure 414: Asian stocks that have superior structural sales growth in their sector (according to our analysts)

Stock	Analyst Comment	CS Rating
Samsung Electronics	Superior balance sheet in a sector where competition is all financially constrained. Multi-sector exposure allows Samsung to weather downturn better than Memory dedicated competition. Also lowest cost producer by virtue of having best technology, biggest scale	Outperform
Taiwan Semicond Manuf	Superior balance sheet in a sector where competition is all financially constrained. Advanced technology and superior execution allow TSMC to gain major allocation from tier-1 clients. Only profitable company even when all the other players have made losses.	Outperform
Hon Hai Precision	Superior balance sheet. Integrated production chain. Diversified product mix. Lowest cost producer by virtue of scale.	Outperform
Infosys Techno		Outperform
Tata Consultancy Services	From next 3-5 year view, our analysts believe that Infosys and Tata should have the best growth within the Indian IT sector and should significantly outgrow their sales compared to global and regional peers.	Outperform
Maruti Suzuki India Ltd	Amongst the most efficient car manufacturer in the world (RoE>cost of capital even in the current year). Benefits from a structural shift to fuel efficient & small cars across the world. Well positioned to grow faster than the rest of the world because of faster market growth in India. Will also benefit from being an outsourcing base	Outperform
CNOOC Ltd	has superior structural sales growth in its sector; also lowest cost producer amongs its peers	Neutral
Reliance Industries	Sales growth expected even in the commodity downturn due to the commissioning of new volumes – refining and upstream gas production. Its costs for putting up new plants (capex) also tends to be very competitive on a global scale (some India specific labor advantages and good execution)	Neutral
Mindray Medical International Ltd	has superior structural sales growth in the global medical devices sector. Taking over global market share from GE, Philips, and others.	Outperform
Shandong Weigao Group Medical	has superior structural sales growth in the global medical devices sector. Taking over China market share from Becton Dickinson (BSX US) and Baxter (BAX US)	Outperform
Wilmar International Ltd	Superior structural sales growth within the plantation sector (palm oil)	Outperform
Sun Pharmac Ind	Superior structural sales growth: more appropriate in Pharma. Sun Pharma (high growth in India because it is exposed to fast growing therapeutic areas, and high growth in the US as it expands its portfolio)	Outperform
Lupin Ltd	Lupin (same as Sun, though focused on volumes and economies of scale; near-term prospects are not good, as the FDA has found some quality issues at a large facility)	Neutral
Dr. Reddy's Laboratories Limited	Steady growth in base revenues; great prospects in Germany - can materially grow its market share; some near-term concerns because of currency depreciation in CIS markets	Outperform
China Shipping Development	State own bulk/energy shipping company - main business bringing oil from Middle East into China and transporting coal within the country. With strong structural demand and big capacity increase, CSD's growth profile with be better than its shipping peers. That said, earnings will be still volatile as it is affected by freight rates movement	Outperform

Source: Credit Suisse estimates

We show the screen of the above-mentioned Asian stocks that also look cheap on HOLT and trade on a P/B relative below their historical norm. This highlights Tata, Hon Hai Precisions, Infosys, Maruti Suzuki and Samsung Electronics, all of which are Credit Suisse Outperform rated.

Figure 415: Asian stocks that have superior structural sales growth in their sector, that look cheap on HOLT and are trading on a P/B relative below their historic norm

	-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Tata Consultancy S	8.4	69%	-42%	3.9	-69%	9.0%	2.9%	-18.0	32.5	7.0	-7.8	-0.8	-4.3	2.2	0.5	31.0	7.5	Outperform
Hon Hai Precision	7.7	n/a	-17%	1.4	-54%	-3.4%	3.7%	-6.9	48.0	6.0	0.7	-0.4	-7.8	-1.2	0.5	-29.4	7.5	Outperform
Infosys Technologi	10.6	86%	-15%	4.2	-45%	6.9%	2.2%	-12.3	8.7	7.0	-4.5	-0.2	-0.3	-0.3	0.0	46.7	7.0	Outperform
Cnooc Ltd	7.0	79%	7%	1.7	-7%	9.1%	6.4%	-13.5	112.3	6.0	1.2	-1.1	-4.6	-5.1	0.5	50.0	6.5	Neutral
Maruti Suzuki Ind	8.5	31%	-8%	1.7	-26%	1.2%	1.0%	-3.8	20.3	5.0	-1.8	-1.1	-14.0	-0.8	0.0	30.8	5.0	Outperform
Samsung Electronic	14.5	81%	130%	1.3	-2%	1.8%	1.6%	-5.8	11.5	4.0	-3.3	-1.5	-18.7	2.9	0.5	57.6	4.5	Outperform

Source: Credit Suisse HOLT, MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Appendix 3

European stocks with more than 2% sales exposure to China.

Figure 416: European stocks with more than 2% sales exposure to China

Name	% Sales to China	-----P/E (12m fwd) ------ Abs	rel to Industry	rel to mkt % above/below average	------ P/B ------- Abs	rel to mkt % above/below average	Yield (08e) FCY	DY	HOLT Implied CFROI less 5-year average	Price, % change to best	Valuation score	---------- Momentum ------------- CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Hsbc Hldgs	40%	9.8	127%	42%	1.1	-14%	n/m	8.1%	-4.5	11.9	5.0	-4.0	-5.6	-10.5	-2.2	0.0	-36.0	6.0	Neutral
Standard Chartered	22%	8.0	104%	18%	1.0	-24%	n/m	5.2%	-3.8	24.9	4.0	0.3	5.5	-2.4	-3.5	1.0	-71.4	6.0	Neutral
Kazakhmys	20%	1.9	35%	-67%	0.2	-89%	53.6%	11.0%	-31.6	340.6	7.0	-11.8	-12.7	-23.6	-12.3	0.0	-20.0	8.0	Outperform
Swatch Group	20%	8.9	78%	4%	1.7	7%	9.5%	2.7%	-0.1	3.7	5.0	0.4	-3.6	-7.5	-1.6	0.5	9.1	5.5	Outperform
Volkswagen Ag	16.2%	35.2	130%	385%	3.4	345%	4.1%	0.6%	7.7	-65.5	0.0	0.4	-0.1	-2.8	0.5	1.0	-100.0	2.0	Underperform
Nokia Oyj	12.5%	10.7	90%	-6%	3.6	24%	15.4%	4.5%	-3.2	8.2	6.0	0.3	-5.1	-8.2	-3.4	0.5	12.0	6.5	Neutral
Bulgari Spa	11.4%	12.5	109%	-4%	1.9	-34%	5.6%	5.9%	0.4	-32.0	4.0	-1.0	-11.6	-14.7	-2.4	0.0	-80.0	5.0	Neutral
Antofagasta	11%	11.0	207%	n/a	1.5	n/a	13.9%	7.4%	-22.2	67.9	6.0	-9.8	-6.8	-14.4	-8.7	0.0	-8.3	7.0	Neutral
Abb Ltd	11%	9.3	87%	-1%	2.8	23%	11.7%	3.8%	0.2	4.2	5.0	4.2	-0.2	-5.3	-2.5	0.5	-12.0	6.5	Underperform
Richemont(Cie Fin)	10%	9.0	79%	n/a	1.1	n/a	9.5%	4.6%	-0.1	-11.4	6.0	-0.4	-0.3	-38.5	0.2	0.5	20.0	6.5	Outperform
Infineon Technolog	10%	-2.0	-11%	-109%	0.2	-69%	-107.7%	0.0%	5.2	545.2	4.0	-12.7	NM	NM	-3.8	0.0	-53.3	5.0	Neutral
Lvmh Moet Hennessy	10%	10.7	94%	-3%	2.1	-1%	7.1%	3.5%	2.8	-40.3	5.0	0.0	-0.9	-2.0	-0.1	0.5	58.6	5.5	Outperform
Jc Decaux Sa	10%	12.9	121%	-16%	1.2	-24%	0.7%	3.8%	2.5	-27.6	3.0	-0.5	-1.6	-5.6	-0.7	0.0	-33.3	4.0	Underperform
Atlas Copco Ab	9%	9.4	110%	18%	5.2	227%	11.9%	5.1%	2.7	-10.2	2.0	4.3	-0.7	0.3	0.9	1.5	4.0	3.5	Underperform
Basf Se	7.6%	8.8	100%	15%	1.2	35%	16.3%	7.7%	-3.3	41.4	5.0	-0.2	-5.0	-8.6	-1.0	0.0	-27.3	6.0	Restricted
Akzo Nobel Nv	7.4%	7.9	90%	21%	0.7	-57%	18.6%	6.3%	2.9	-11.4	4.0	0.4	-0.3	-1.9	2.6	1.0	-4.0	6.0	Underperform
Koninklijke Dsm Nv	7.3%	5.5	62%	-1%	0.5	-15%	25.8%	7.7%	-6.0	92.1	7.0	0.9	1.2	4.3	0.3	2.0	-15.8	10.0	Outperform
Ericsson(Lm)Tel	7.2%	13.7	116%	2%	1.6	-34%	9.0%	3.2%	1.4	-19.6	3.0	-2.3	2.1	4.4	2.5	1.5	-48.7	5.5	Underperform
Schneider Electric	7%	8.3	78%	-18%	1.4	24%	14.4%	6.8%	-2.8	23.9	6.0	2.5	-0.4	-0.4	0.5	1.0	-4.8	8.0	Neutral
Skf Ab	6.5%	7.5	89%	2%	2.1	95%	14.8%	7.6%	-1.2	11.8	5.0	0.7	-1.4	-2.4	0.8	1.0	-41.7	7.0	NR
Philips Elec(Kon)	6.4%	10.5	109%	22%	0.8	-10%	13.0%	4.5%	2.9	6.5	3.0	2.7	-7.4	-13.0	-3.6	0.5	-13.5	4.5	Outperform
Wpp Group	6%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	Outperform
Norske Skogindustr	6%	-21.3	-1.5	-389%	0.2	-62%	-1.2%	0.0%	2.3	172.8	4.0	-0.8	NM	NM	0.3	1.0	-37.5	6.0	Neutral
Publicis Groupe Sa	6%	9.2	87%	-5%	2.0	-46%	12.7%	3.3%	4.1	-24.7	5.0	4.5	-0.1	0.1	0.0	1.0	23.8	6.0	Outperform
Alstom	6%	10.2	95%	27%	5.8	226%	7.7%	2.6%	15.1	-35.9	2.0	10.8	0.2	-1.2	-0.5	1.0	-36.4	4.0	Neutral
Rexam	6%	9.3	95%	29%	1.2	-30%	2.6%	5.8%	6.0	-74.7	3.0	-1.2	0.1	0.4	0.9	1.5	20.0	4.5	Outperform
Siemens Ag	5.7%	8.7	90%	-8%	1.3	4%	7.7%	3.7%	3.4	-1.6	3.0	2.3	-0.5	-3.3	0.1	1.0	20.0	4.0	Outperform
Renault Sa	5.6%	3.9	14%	-26%	0.2	-62%	11.9%	14.0%	-1.5	357.7	7.0	-2.4	-6.1	-26.1	-3.8	0.0	-44.8	8.0	Underperform
Alcatel-Lucent	5%	6.2	52%	-36%	0.4	-66%	34.9%	0.6%	-4.4	175.4	6.0	3.9	-6.6	-16.6	-1.2	0.5	-15.2	7.5	Outperform
Stmicroelectronics	5%	12.6	70%	0%	0.6	-64%	17.4%	5.3%	-3.2	89.0	7.0	-0.1	-14.1	-15.7	1.0	0.5	-60.0	8.5	Underperform
Sappi	5%	5.3	37%	-58%	0.3	-68%	26.6%	4.1%	3.3	8.2	5.0	2.5	1.3	-16.3	NM	1.3	0.0	6.3	NR
Soitec S.A.	5%	-19.4	-108%	-181%	0.5	-71%	-48.6%	0.0%	1.9	4.0	4.0	-6.7	NM	NM	-11.0	0.0	-83.3	5.0	Neutral
Asml Holding Nv	5%	19.8	110%	37%	2.7	-27%	6.7%	2.0%	-3.0	-31.8	3.0	-5.9	-0.3	-6.9	-3.6	0.0	-48.4	4.0	Outperform
Kingfisher	4.7%	13.6	103%	55%	0.6	-49%	-1.2%	3.9%	2.2	-84.3	2.0	-0.7	0.0	-2.6	-1.4	0.0	-69.2	3.0	Neutral
Linde Ag	4.7%	10.3	117%	-1%	1.2	3%	11.7%	3.0%	2.8	-19.0	2.0	1.9	-0.3	-1.8	-0.6	0.5	26.7	2.5	Outperform
Bayer Motoren Werk	4.3%	13.6	50%	78%	0.7	-47%	8.6%	3.9%	-2.9	36.1	5.0	-2.6	-2.0	-20.1	-3.5	0.0	-25.0	6.0	Outperform
Tnt Nv	4.1%	7.6	58%	-2%	3.0	26%	15.2%	5.9%	-0.7	0.9	6.0	0.0	-2.5	-8.9	-0.8	0.5	9.1	6.5	Outperform
M-Real Oyj	4%	-12.5	-87%	-297%	0.2	-51%	-1.1%	4.1%	2.4	152.1	4.0	0.5	NM	NM	-17.9	1.0	-7.7	6.0	Outperform
Stora Enso Oyj	4%	16.6	116%	116%	0.6	-8%	4.8%	7.2%	-0.2	23.7	4.0	-2.3	3.8	20.4	-2.9	1.0	-29.4	6.0	Outperform
Upm-Kymmene Corp	4%	12.8	89%	67%	0.8	21%	10.0%	7.1%	-0.5	25.3	5.0	0.3	2.1	0.1	-2.8	1.5	0.0	6.5	Neutral
Groupe Danone	4%	14.5	112%	45%	2.5	41%	4.9%	2.7%	13.7	-75.2	0.0	-2.4	-0.2	0.0	-0.2	0.0	14.3	0.0	Outperform
Sandvik Ab	4%	8.2	97%	2%	2.1	21%	9.9%	7.9%	-2.8	6.2	5.0	-1.6	-2.6	-6.0	-0.8	0.0	-40.7	6.0	Neutral
Carrefour	3.5%	10.6	83%	-8%	2.1	-28%	2.3%	3.8%	2.4	-31.9	4.0	0.7	-0.7	-1.4	0.0	0.5	-31.0	5.5	Neutral
Utd Business Med L	3%	8.1	76%	n/a	3.0	n/a	14.0%	5.3%	-12.8	-60.9	6.0	23.6	0.0	0.0	1.5	1.0	30.0	7.0	Outperform
Lafarge	3%	5.5	57%	-22%	0.6	-35%	8.5%	7.6%	-0.6	25.5	7.0	0.6	-4.2	-9.4	-1.6	0.5	10.0	7.5	Underperform
Mondi	3%	7.2	50%	n/a	0.3	n/a	14.4%	10.8%	-4.3	117.3	7.0	0.4	0.0	-12.4	-2.3	0.5	14.3	7.5	Underperform
Veolia Environneme	3%	9.7	96%	-8%	1.2	-37%	-7.3%	7.1%	2.6	-46.9	4.0	-0.8	-3.5	-16.8	-1.1	0.0	-53.9	5.0	Neutral
Reckitt Benck Grp	3%	15.4	111%	59%	7.4	127%	5.6%	2.7%	5.5	-40.7	2.0	9.6	0.1	2.6	1.8	2.0	25.0	4.0	Outperform
L'Oreal	3%	16.2	111%	8%	3.5	17%	5.4%	2.4%	7.4	-37.2	1.0	-1.8	-0.3	-2.1	-0.3	0.0	-60.0	2.0	Neutral
Holcim	3%	9.3	96%	28%	1.0	0%	2.0%	4.1%	-1.0	13.6	4.0	-0.3	-9.3	-12.1	-1.8	0.0	-33.3	5.0	Underperform
Beiersdorf Ag	3%	18.2	125%	28%	4.5	53%	5.3%	1.8%	8.1	-42.2	1.0	2.2	-0.6	-2.4	0.4	1.0	-3.2	3.0	Neutral
Daimler Ag	2.3%	9.3	34%	-4%	0.7	-34%	8.4%	6.3%	-2.1	43.4	7.0	-1.8	-2.8	-29.4	-2.8	0.0	-11.1	8.0	Outperform
Svenska Cellulosa	2%	10.0	69%	33%	0.8	-14%	9.1%	6.5%	-0.1	-2.8	5.0	-0.6	-0.5	-3.5	-0.1	0.0	-20.0	6.0	Neutral
Unilever Plc	2.0%	12.4	96%	44%	4.4	27%	7.4%	4.0%	7.5	-40.9	3.0	-0.1	-0.2	5.1	2.3	1.0	-33.3	5.0	Underperform
Legrand Sa	2.0%	10.8	101%	n/a	1.8	n/a	13.0%	4.9%	1.2	-31.2	3.0	-0.7	-1.3	-5.4	-1.3	0.0	-87.5	4.0	Underperform
Nestle Sa	2.0%	13.0	101%	38%	3.5	73%	5.8%	3.1%	5.3	-20.6	1.0	1.8	0.9	0.1	-0.1	1.5	16.7	2.5	Outperform

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse HOLT, Credit Suisse research

US stocks with more than 2% sales exposure to China.

Figure 417: US stocks with more than 2% sales exposure to China

Name	% Sales to China	P/E (12m fwd): Abs	P/E (12m fwd): rel to Industry	P/E (12m fwd): rel to mkt % above/below average	P/B: Abs	P/B: rel to mkt % above/below average	Yield (08e): FCY	Yield (08e): DY	HOLT: Implied CFROI less 5-year average	HOLT: Price, % change to best	Valuation score	Momentum: CFROI	Momentum: 1m EPS	Momentum: 3m EPS	Momentum: 3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Qualcomm Inc	21%	15.3	129%	-26%	3.1	9%	4.1%	1.8%	-1.5	-11.4	2.0	1.3	0.0	-0.1	-0.3	0.5	70.4	2.5	Outperform
Yum Brands Inc	20.6%	13.5	112%	41%	35.4	423%	5.0%	2.3%	4.6	-29.3	1.0	2.1	-0.1	-0.1	-0.4	0.5	-41.2	2.5	Outperform
Danaher Corp	9%	11.6	136%	9%	1.6	-27%	9.0%	0.2%	-9.7	38.3	4.0	-2.5	-0.4	-2.0	-1.6	0.0	22.2	4.0	Neutral
Johnson Controls	8%	10.0	107%	30%	1.2	-9%	11.2%	2.3%	-1.1	-6.0	3.0	-0.2	0.0	0.0	-0.4	0.0	-57.1	4.0	Outperform
Emerson Electric	8%	11.1	104%	7%	2.6	13%	9.2%	3.7%	3.0	-17.6	2.0	2.0	0.0	-0.1	0.1	1.0	0.0	3.0	Outperform
Motorola Inc	7%	37.1	313%	177%	0.6	-64%	4.9%	4.9%	-5.4	62.8	4.0	-4.6	-3.7	-20.4	-4.8	0.0	-64.7	5.0	Underperform
Du Pont (E I) De	7%	11.4	130%	24%	1.9	-14%	11.5%	6.4%	1.4	-25.1	3.0	-0.3	-11.0	-16.5	-3.3	0.0	-17.7	4.0	Outperform
Spx Corp	6%	5.4	64%	-32%	0.7	-32%	18.5%	3.2%	2.1	2.4	5.0	3.4	-0.1	-2.4	-4.3	0.5	-11.1	6.5	Neutral
Rayonier Inc	6%	16.3	n/a	n/a	2.3	n/a	n/m	6.8%	2.5	-39.5	0.0	-1.3	0.0	-0.8	-0.9	0.0	14.3	0.0	Outperform
Coca-Cola Co	5.5%	13.6	107%	-8%	4.4	-42%	6.1%	3.4%	6.4	-30.5	3.0	-0.2	0.1	1.1	-2.9	1.0	50.0	4.0	Neutral
Albany Intl Corp -Cl	5%	8.6	101%	5%	0.8	-31%	-10.6%	n/a	0.1	-15.2	1.0	-0.6	NM	NM	NM	0.0	n/a	1.0	Outperform
Nike Inc	5%	12.5	109%	31%	3.2	29%	6.6%	1.9%	1.8	-13.5	1.0	1.6	-0.8	1.8	0.3	1.5	42.9	2.5	Outperform
Boeing Co	4.3%	6.7	80%	-35%	3.4	74%	9.6%	3.9%	-4.7	55.4	6.0	-1.9	-1.0	-19.4	-8.9	0.0	13.0	6.0	Outperform
Mosaic Co	4%	3.4	39%	n/a	1.8	n/a	27.2%	0.6%	-6.8	306.8	6.0	15.8	-20.7	-39.7	-23.2	0.5	9.1	6.5	Outperform
Procter & Gamble	4%	14.1	101%	21%	2.8	-28%	6.3%	2.4%	10.1	-46.6	2.0	0.8	0.0	0.0	0.0	0.5	0.0	2.5	NR
Mcdonald'S Corp	4%	15.6	130%	57%	5.1	136%	4.8%	2.8%	7.8	-51.4	0.0	2.9	0.1	2.3	-0.6	1.5	22.2	1.5	Neutral
United	4%	9.5	113%	11%	2.2	21%	10.0%	2.7%	-2.2	20.5	3.0	1.9	-0.2	-0.3	-1.6	0.5	44.4	3.5	Outperform
Cooper Industries	3%	9.4	88%	5%	1.7	25%	12.0%	3.5%	-0.7	-16.1	4.0	-1.4	-3.6	-4.4	-2.1	0.0	-46.7	5.0	Neutral
Omnicom Group	3%	8.9	84%	-16%	2.3	-26%	11.5%	2.3%	2.1	-15.9	4.0	5.2	-0.2	-3.2	-3.1	0.5	-20.0	5.5	Neutral
Invesco Ltd	3%	11.4	137%	n/a	0.8	n/a	n/m	3.5%	-9.4	-33.1	2.0	-12.0	-2.7	-14.1	27.8	0.5	14.3	2.5	Outperform
Western Union Co	2.5%	9.1	74%	n/a	13.0	n/a	9.6%	0.0%	-28.5	20.5	6.0	-17.7	-0.2	-2.2	-1.2	0.0	18.2	6.0	Neutral
Pepsico Inc	2.3%	13.3	105%	12%	5.0	26%	5.5%	3.1%	2.7	-21.8	1.0	0.7	0.0	-1.7	0.1	1.0	46.7	2.0	Outperform
Coach Inc	2.0%	8.8	77%	-39%	4.8	-26%	10.0%	n/a	-1.4	12.5	7.0	4.3	0.0	0.0	0.0	0.5	15.8	7.5	Neutral
Alliancebernstein	2.0%	8.6	103%	n/a	1.1	n/a	n/m	13.6%	-11.3	-16.8	4.0	-11.6	-0.9	-25.3	NM	0.0	14.3	4.0	Outperform
Tiffany & Co	2.0%	10.8	81%	-5%	1.7	-22%	7.9%	2.8%	0.9	-11.1	5.0	0.8	-11.2	-15.3	-7.0	0.5	-28.6	6.5	Neutral
Blackrock Inc	2.0%	18.4	221%	n/a	1.2	n/a	n/m	2.3%	-13.4	33.6	4.0	-5.1	-0.7	-17.4	-8.2	0.0	-25.0	5.0	Neutral
General Electric Co	2.0%	11.3	118%	8%	1.5	-40%	2.7%	6.9%	-1.5	-16.2	3.0	-2.6	-2.6	-13.8	-1.6	0.0	-46.7	4.0	Neutral
Franklin Resources	2.0%	13.0	156%	33%	2.0	0%	n/m	1.3%	3.5	-34.6	1.0	3.4	0.0	-2.3	-1.4	0.5	-20.0	2.5	Neutral
L-3	1.5%	9.2	110%	-16%	1.4	13%	12.3%	1.7%	-8.7	64.1	4.0	-0.6	0.1	1.8	-0.7	1.0	-20.0	6.0	Neutral
General Dynamics	1.5%	8.0	95%	-2%	1.7	14%	10.5%	2.4%	-4.8	36.6	5.0	1.9	0.0	0.9	-1.3	1.0	20.0	6.0	Neutral

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Appendix 4 : Short asset-life US companies

Figure 418: US companies in short asset-life industries that have consistently delivered positive earnings growth in the past ten years and that are cheap on HOLT or are Outperform-rated

			-----P/E (12m fwd) ------			------ P/B -------		Yield (08e)		HOLT			---------- Momentum -------------							
Name	EPS growth, 10 year CAGR	Net Debt as a % of Mcap	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Implied CFROI less 5-year average	Price, % change to best	Valuation score	CFROI	1m EPS	3m EPS	3m Sales	Momentum score	Consensus (buy less holds & sells)	Overall score	Credit Suisse rating
Biogen Idec Inc	35%	0%	11.8	70%	-45%	2.4	14%	6.3%	0.0%	-4.3	21.1	5.0	0.9	0.1	2.4	3.2	2.0	-18.5	8.0	Neutral
Cardinal Health Inc	14%	39%	7.8	95%	-34%	1.4	-36%	12.5%	n/a	-4.6	18.5	7.0	-0.2	0.0	0.0	0.0	0.0	25.0	7.0	Outperform
St Jude Medical Inc	20%	13%	11.9	96%	-7%	3.0	-14%	6.1%	n/a	-5.8	23.5	7.0	-0.6	-0.7	-0.9	-0.9	0.0	23.1	7.0	Neutral
Patterson Companies Inc	17%	21%	9.8	119%	-25%	2.1	-26%	9.0%	n/a	-7.3	13.0	6.0	-2.5	-10.6	-10.8	-2.4	0.0	-45.5	7.0	Neutral
Amphenol Corp	24%	23%	10.2	n/a	1%	2.6	-33%	10.1%	0.4%	-8.2	35.8	6.0	0.8	-2.5	-2.9	-1.9	0.5	27.3	6.5	Outperform
Linear Technology Corp	11%	19%	14.0	78%	-9%	-11.3	-431%	9.0%	n/a	6.3	-57.2	5.0	1.9	0.0	0.0	0.0	0.5	-33.3	6.5	Outperform
Dell Inc	9%	-6%	9.1	82%	-22%	8.2	-13%	10.6%	0.0%	-6.5	-0.6	5.0	0.0	0.3	-5.5	-6.6	0.5	-17.2	6.5	Outperform
Oracle Corp	21%	3%	10.8	98%	-22%	3.7	-43%	8.6%	0.0%	-12.6	58.7	6.0	-1.5	-1.9	-1.7	-5.0	0.0	44.8	6.0	Neutral
Citrix Systems Inc	16%	-7%	13.5	123%	-19%	2.4	-11%	5.0%	0.0%	-9.3	36.2	5.0	0.2	0.0	3.1	-0.4	1.0	9.7	6.0	Outperform
Amerisourcebergen Corp	19%	25%	9.5	114%	-7%	1.8	58%	8.8%	1.0%	6.4	6.9	4.0	10.4	0.0	0.4	-0.1	1.0	-25.0	6.0	Outperform
Lincare Holdings Inc	16%	45%	10.4	126%	4%	1.9	-8%	11.6%	0.0%	-7.9	0.6	4.0	3.8	0.0	0.5	-1.4	1.0	-23.1	6.0	Neutral
Schein (Henry) Inc	30%	14%	10.0	122%	n/a	1.5	n/a	9.0%	0.0%	-4.1	32.2	4.0	2.0	-1.0	-1.3	-2.3	0.5	-20.0	5.5	Outperform
Johnson & Johnson	15%	7%	12.4	120%	10%	3.5	-7%	7.6%	3.2%	-7.5	20.7	4.0	-2.5	0.0	0.5	-0.5	0.5	26.3	4.5	Neutral
Laboratory Cp Of Amer Hldgs	25%	38%	12.1	146%	20%	4.0	92%	7.9%	0.0%	-0.3	-9.6	2.0	1.9	-0.1	-0.4	-0.1	0.5	64.7	2.5	Outperform
Express Scripts Inc	35%	14%	15.8	191%	15%	16.6	292%	5.5%	0.0%	6.7	-23.3	1.0	5.7	0.0	0.7	2.8	1.5	28.0	2.5	Outperform
Apple Inc	25%	-23%	17.8	159%	16%	4.2	135%	4.7%	0.0%	3.2	-45.8	0.0	2.9	0.0	0.0	-0.1	0.5	57.6	0.5	Outperform

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Appendix 5: US stocks and sectors with high negative correlation to credit spreads

Figure 419: **US sectors' negative correlation with the US CDX high-yield**

Sector	Correlation coefficient
Diversified Financials	-0.46
Automobiles	-0.40
Construction Materials	-0.33
Insurance	-0.32
Real Estate	-0.32
Banks	-0.31
Retailing	-0.25
Metals & Mining	-0.23
Consumer Durables	-0.23
Paper	-0.12
Chemicals	-0.11
Media	-0.08
Hotels & Leisure	-0.03
Energy	0.01
Commercial Services	0.03
Transport	0.04
Telecoms	0.04
Semiconductors	0.04
Capital Goods	0.07
Health Care	0.21
Technology Hardware	0.21
Utilities	0.25
Software	0.26
Food Staples	0.36
Tobacco	0.37
Pharma	0.40
Food Products	0.40
Household Products	0.45
Beverages	0.45

Source: Credit suisse Locus, Credit Suisse research

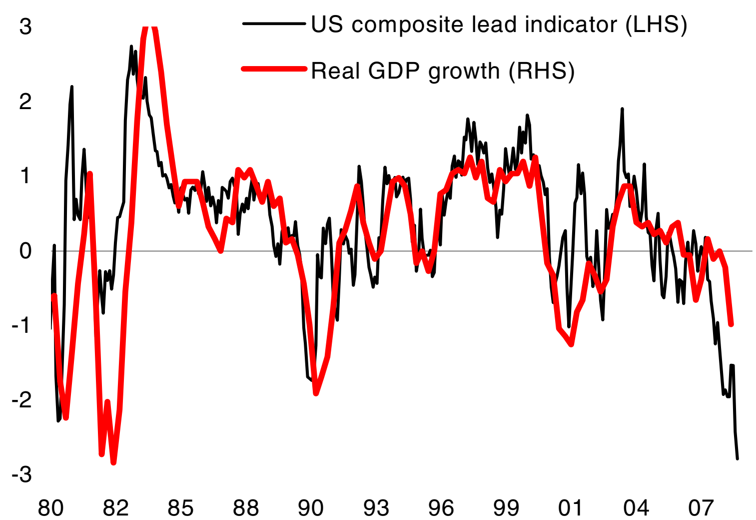
Figure 420: **US stocks with the highest negative correlation with the US CDX high-yield**

Company	Sector	Correlation with iTraxx crossover	Credit Suisse rating
Invesco	Div Financials	-0.65	Outperform
Nordstrom	Retailing	-0.45	Outperform
Ameriprise Finl.	Div Financials	-0.43	Outperform
Metlife	Insurance	-0.40	Outperform
Jacobs Engr.	Capital Goods	-0.39	Outperform
Best Buy	Retailing	-0.38	Outperform
Simon Pr.Gp.	Real Estate	-0.35	Outperform
Lincoln Nat.	Insurance	-0.35	Outperform
Jp Morgan Chase & Co.	Div Financials	-0.33	Outperform
Alcoa	Materials	-0.33	Outperform
Abercrombie & Fitch	Retailing	-0.32	Outperform
Quanta Services	Capital Goods	-0.32	Outperform
Goldman Sachs Gp.	Div Financials	-0.30	Outperform

Source: Credit suisse Locus, Credit Suisse research

Appendix 6

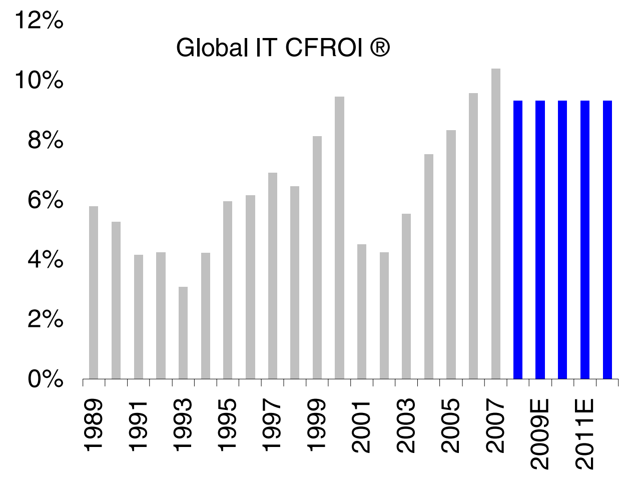
Figure 421: Our composite lead indicator is now the weakest it has been for 30 years and is consistent with a 2% y/y decline in US real GDP



Source: ISM, University of Michigan, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

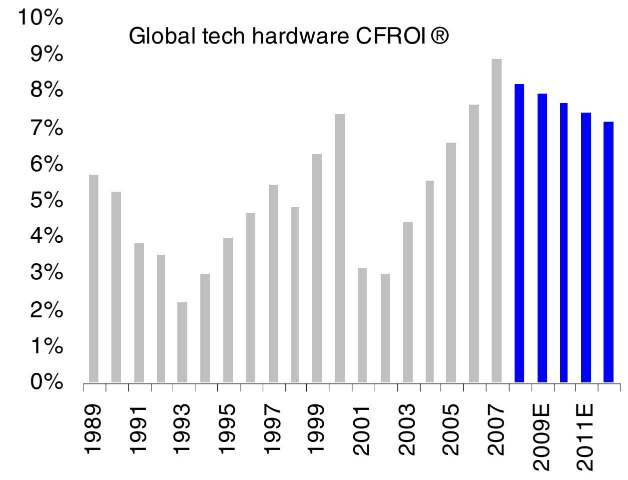
Appendix 7: Tech on HOLT

Figure 422: **Global IT on HOLT (implied CFROI®)**



Source: Credit Suisse HOLT

Figure 423: **Global tech hardware on HOLT (implied CFROI®)**



Source: Credit Suisse HOLT

Appendix 8: US defensiveness and valuation scorecards

Figure 424: US sectors' defensiveness scorecard

US Sector	OECD LI & Price rel: correlation	Net debt / market cap	Historical volatility CFROI	Historical volatility EPS	OECD LI & earnings correlation	Earnings momentum	Overall Rank
Pharma	-0.58	1%	8%	6%	-4%	0%	1
Beverages	-0.50	10%	6%	8%	-26%	-14%	2
Food Producers	-0.51	30%	7%	6%	-41%	-15%	3
HH Products	-0.53	15%	16%	8%	-25%	-21%	4
Food Retailing	-0.49	20%	8%	33%	-35%	-21%	5
Software	-0.09	-5%	19%	10%	-21%	-21%	6
Healthcare Equip	-0.22	9%	15%	14%	30%	-18%	7
Tobacco	0.03	10%	8%	20%	-2%	-11%	8
Utilities	-0.13	55%	13%	11%	-22%	-7%	9
Energy	-0.15	8%	46%	43%	18%	-33%	10
Capital Goods	0.19	8%	20%	7%	-27%	-29%	11
Transport	-0.20	19%	21%	26%	15%	-6%	12
Media	-0.06	41%	15%	125%	-15%	-22%	13
Hotels & Leisure	0.21	17%	4%	12%	-8%	-21%	14
Commercial Services	0.11	25%	10%	12%	10%	-28%	15
Consumer Durables	-0.05	18%	17%	22%	46%	-26%	16
Technology Hardware	0.20	-6%	38%	42%	40%	-35%	17
Retailing	0.14	12%	16%	13%	52%	-30%	18
Telecoms	0.07	58%	17%	22%	1%	-22%	19
Semiconductors	0.38	-8%	39%	54%	44%	-35%	20
Automobiles	0.33	9%	32%	74%	45%	-38%	21

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Figure 425: US defensives' valuation scorecard

US Sectors	FCFY 2008e	P/B rel	VCR	Overall rank
Telecoms	7.1%	92%	96%	1
Energy	6.0%	101%	115%	2
Utilities	0.6%	84%	101%	3
Healthcare Equip	9.6%	115%	223%	4
Pharma	8.9%	170%	175%	5
Food Producers	6.4%	113%	191%	6
Tobacco	9.2%	414%	274%	7
Food Retailing	2.8%	133%	187%	8
Beverages	5.9%	237%	290%	9
HH Products	5.9%	203%	404%	10

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Appendix 9

Figure 426: US cyclicals relative to defensives: P/B

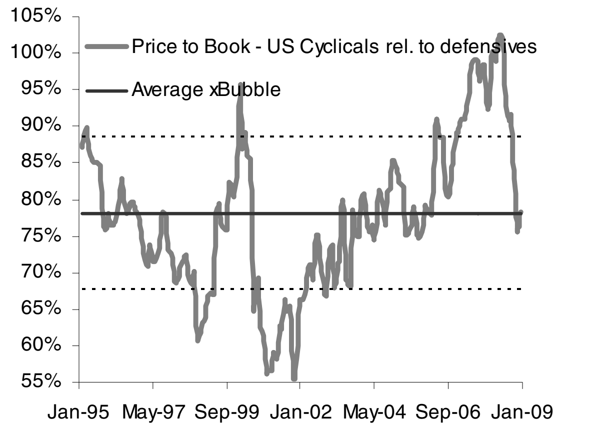

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Figure 427: US cyclicals relative market: P/B

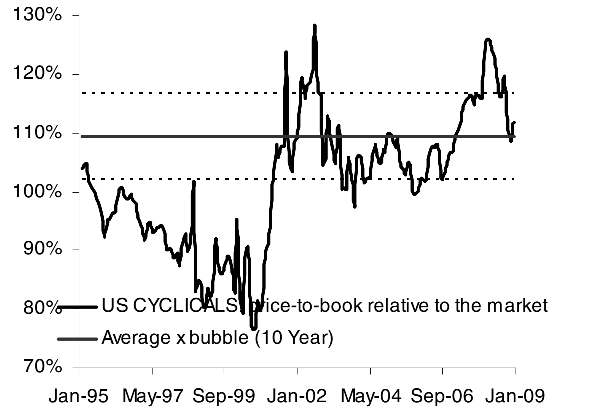

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Figure 428 shows for the US sectors' consensus sales growth estimates and their revisions over the past six months.

Figure 428: US sectors' consensus revenue estimates and revisions over the past six months

USA sectors	2008e revenue growth		2009e revenue growth	
	Now	6m chg	Now	6m chg
Automobiles & Components	-5.8%	-8.9%	-1.2%	-6.4%
Banks	7.5%	-0.7%	13.3%	6.1%
Capital Goods	10.4%	0.0%	4.5%	-3.4%
Commercial & Professional Services	6.1%	-3.5%	-6.1%	-11.3%
Consumer Durables & Apparel	-8.9%	-1.6%	-6.0%	-7.5%
Consumer Services	7.2%	-1.5%	2.9%	-5.0%
Diversified Financials	-10.1%	-14.8%	28.7%	12.4%
Energy	28.5%	6.7%	6.5%	-6.2%
Food & Staples Retailing	9.6%	1.2%	6.8%	-0.4%
Food Beverage & Tobacco	8.9%	3.0%	3.3%	-1.8%
Health Care Equipment & Services	8.6%	0.2%	5.8%	-1.0%
Household & Personal Products	9.9%	0.3%	1.3%	-4.7%
Insurance	1.5%	-2.2%	2.9%	-2.6%
Materials	12.9%	-0.3%	-2.0%	-6.1%
Chemicals	15.9%	2.3%	3.8%	-2.4%
Construction Materials	7.3%	-10.7%	-0.2%	-7.8%
Containers & Packaging	4.5%	-1.8%	1.0%	-2.8%
Metals & Mining	19.6%	-0.6%	-11.2%	-14.3%
Paper & Forest Products	-3.2%	-3.6%	3.8%	3.0%
Media	7.0%	0.0%	2.1%	-3.5%
Pharmaceuticals Biotechnology & Life Sciences	9.8%	0.9%	4.4%	-1.2%
Real Estate	-1.9%	-2.2%	-0.5%	-3.9%
Retailing	2.4%	-0.4%	3.4%	-2.6%
Semiconductors & Semiconductor Equipment	0.2%	-3.0%	-2.1%	-11.0%
Software & Services	18.2%	1.4%	9.1%	-3.4%
Technology Hardware & Equipment	10.2%	0.4%	6.2%	-1.0%
Telecommunication Services	1.9%	-0.8%	2.8%	-0.3%
Transportation	10.4%	1.5%	3.8%	-3.7%
Utilities	4.7%	2.0%	2.6%	-1.1%
Cyclicals	**7.2%**	**-0.7%**	**3.0%**	**-3.8%**
Market	**7.3%**	**-0.4%**	**4.9%**	**-2.0%**

Source: MSCI, I/B/E/S, Factset, © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

Figure 429: US cyclicals sectors' consensus sales growth

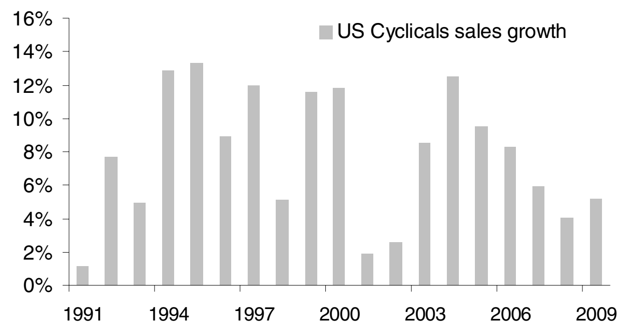

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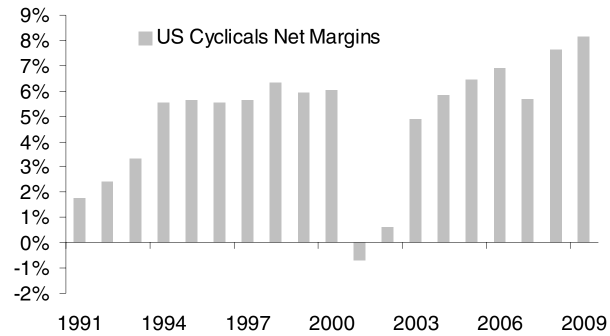
Figure 430: US cyclicals sectors' consensus net income margins



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Appendix 10: US cyclicals scorecard

Figure 431: **US cyclicals overall scorecard**

US Sector	Valuation	Cyclicality	Revenues	Margins	Leverage	Earnings Momentum	Overall Rank
Retailing	5	0.17	0.05	-0.15	12.4%	-31.9%	1
Commercial Services	3	0.13	-0.43	0.19	25.4%	-44.4%	2
Media	2	-0.03	0.13	0.60	41.3%	-26.8%	3
Semiconductors	4	0.39	0.22	-0.40	-8.1%	-39.9%	4
Capital Goods	8	0.19	-0.02	0.97	7.6%	-30.2%	5
Automobiles	6	0.33	0.05	-1.22	9.3%	-43.8%	6
Software	10	-0.10	0.14	1.23	-4.8%	-22.9%	7
Technology Hardware	11	0.21	-3.81	0.85	-5.6%	-43.7%	8
Chemicals	7	-0.26	0.01	1.46	15.8%	-42.4%	9
Metals and Mining	1	0.47	-0.31	0.35	16.9%	-44.8%	10
Hotels & Leisure	9	0.23	0.32	0.38	17.2%	-19.5%	11
Transport	13	-0.21	0.52	1.06	18.6%	-0.6%	12
Construction Materials	12	0.13	0.24	-1.15	50.5%	-39.7%	13

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Figure 432: **US cyclicals valuation scorecard**

US Sector	P/B		EV/Sales		VCR		
	Current	rel to market SDs above/ below average	Current	SDs above/ below average	Current	SDs above/ below average	Overall Rank
Metals & Mining	0.9	-1.8	0.6	-2.4	104%	-1.1	1
Media	0.9	-0.1	1.6	-1.7	115%	-2.1	2
Commercial Services	2.1	-0.2	1.0	-1.7	175%	-1.0	3
Semiconductors	1.8	-1.1	1.4	-0.9	105%	-1.2	4
Retailing	1.7	-0.8	0.5	-1.6	132%	-0.8	5
Automobiles	-0.9	1.5	0.2	-2.7	84%	-0.9	6
Chemicals	2.1	0.4	1.0	-1.8	123%	-0.2	7
Capital Goods	1.6	-1.6	1.3	-0.6	168%	-0.4	8
Hotels & Leisure	2.8	1.9	1.7	-1.2	152%	-1.2	9
Software	3.1	0.6	2.3	-1.2	295%	-0.5	10
Technology Hardware	2.2	0.1	1.0	-1.1	167%	-0.2	11
Construction Materials	2.1	0.5	2.6	1.0	164%	0.7	12
Transportation	1.8	1.4	1.2	-0.5	108%	0.1	13

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Companies Mentioned *(Price as of 16 Dec 08)*
3M (MMM, $55.63, NEUTRAL, TP $61.00)
ABB (ABBN.VX, SFr15.84, UNDERPERFORM, TP SFr16.00, UNDERWEIGHT)
Abercrombie & Fitch Co. (ANF, $20.38, OUTPERFORM, TP $40.00)
Aberdeen Asset Management (ADN.L, 97.25p, NEUTRAL, TP 98.00p, OVERWEIGHT)
Abertis (ABE.MC, Eu 13.03, UNDERPERFORM, TP Eu 18.00, OVERWEIGHT)
Accenture Ltd. (ACN, $29.04, OUTPERFORM, TP $48.00)
Acciona SA (ANA.MC, Eu 83.80, OUTPERFORM, TP Eu 105.00, MARKET WEIGHT)
Accor (ACCP.PA, Eu 33.30, OUTPERFORM, TP Eu 58.00, MARKET WEIGHT)
ACE Limited (ACE, $48.16, OUTPERFORM, TP $68.00)
Acerinox (ACX.MC, Eu 12.25, UNDERPERFORM, TP Eu 6.00, OVERWEIGHT)
ACS (ACS.MC, Eu 31.01, UNDERPERFORM, TP Eu 20.00, OVERWEIGHT)
Adidas AG (ADSG.F, Eu 26.74, OUTPERFORM, TP Eu 40.00, OVERWEIGHT)
Adobe Systems Inc. (ADBE, $21.36, OUTPERFORM [V], TP $26.50)
Advanced Info Service PCL (ADVA.BK, Bt75.00, OUTPERFORM, TP Bt108.00)
Aegis Group (AEGS.L, 63.75p, NEUTRAL, TP 100.00p, UNDERWEIGHT)
Aegon (AEGN.AS, Eu 4.73, OUTPERFORM, TP Eu 7.50, MARKET WEIGHT)
Agricultural Bank of Greece (AGBr.AT, Eu 1.44, NEUTRAL, TP Eu 2.80, MARKET WEIGHT)
Ahold (AHLN.AS, Eu 8.80, OUTPERFORM, TP Eu 11.00, MARKET WEIGHT)
Air Liquide (AIRP.PA, Eu 62.63, NEUTRAL, TP Eu 81.00, UNDERWEIGHT)
Air Products and Chemicals, Inc. (APD, $48.54, OUTPERFORM, TP $75.00)
AIXTRON (AIXG.DE, Eu 3.89, NEUTRAL [V], TP Eu 5.20, OVERWEIGHT)
Akamai Technologies Inc. (AKAM, $13.84, NEUTRAL [V], TP $16.00)
Akzo Nobel (AKZO.AS, Eu 27.92, UNDERPERFORM, TP Eu 29.00, UNDERWEIGHT)
Albany International Corp. (AIN, $13.08, OUTPERFORM, TP $30.00)
Alcatel-Lucent (ALUA.PA, Eu 1.62, OUTPERFORM [V], TP Eu 4.00, MARKET WEIGHT)
Alcoa Inc. (AA, $9.91, OUTPERFORM [V], TP $20.00)
Alleanza (ALZI.MI, Eu 5.84, OUTPERFORM, TP Eu 8.60, MARKET WEIGHT)
AllianceBernstein (AB, $17.88, OUTPERFORM, TP $28.00)
Alpha Bank (ACBr.AT, Eu 6.02, OUTPERFORM, TP Eu 15.50, MARKET WEIGHT)
Alstom (ALSO.PA, Eu 44.03, NEUTRAL, TP Eu 36.00, UNDERWEIGHT)
Altera Corp. (ALTR, $15.53, NEUTRAL [V], TP $15.00)
Altria Group, Inc. (MO, $15.21, OUTPERFORM, TP $21.00)
Amazon.com Inc. (AMZN, $48.85, NEUTRAL [V], TP $60.00)
American Electric Power Co., Inc. (AEP, $29.22, OUTPERFORM, TP $41.00)
American International Group Inc. (AIG, $1.80, NEUTRAL [V], TP $1.50)
Ameriprise Financial Inc. (AMP, $18.78, OUTPERFORM, TP $30.00)
AmerisourceBergen Corp. (ABC, $33.13, OUTPERFORM, TP $47.00)
Amgen Inc. (AMGN, $57.71, OUTPERFORM, TP $72.00)
Amphenol Corporation (APH, $21.55, OUTPERFORM, TP $28.00)
Anadarko Petroleum Corp. (APC, $37.31, OUTPERFORM, TP $50.00)
Analog Devices Inc. (ADI, $18.87, NEUTRAL, TP $16.00)
Antena 3 (A3TV.MC, Eu 4.94, NEUTRAL, TP Eu 4.60, UNDERWEIGHT)
Antofagasta (ANTO.L, 444.25p, NEUTRAL [V], TP 330.00p, OVERWEIGHT)
Apple Inc. (AAPL, $94.75, OUTPERFORM [V], TP $120.00)
Applied Materials Inc. (AMAT, $10.19, NEUTRAL, TP $8.25)
ArcelorMittal (MT.N, $23.36, OUTPERFORM [V], TP $82.00, OVERWEIGHT)
Arrow Electronics, Inc. (ARW, $15.78, NEUTRAL, TP $19.00)
ASML Holding N.V. (ASML.AS, Eu 12.27, OUTPERFORM, TP Eu 14.00, MARKET WEIGHT)
Atlas Copco (ATCOa.ST, SKr62.75, UNDERPERFORM, TP SKr59.00, UNDERWEIGHT)
Autodesk Inc. (ADSK, $17.61, NEUTRAL, TP $10.50)
Automatic Data Processing, Inc. (ADP, $37.47, NEUTRAL, TP $36.00)
AVIVA Plc (AV.L, 366.75p, OUTPERFORM, TP 503.50p, MARKET WEIGHT)
Avnet Inc. (AVT, $16.11, NEUTRAL, TP $17.00)
AXA (AXAF.PA, Eu 15.09, UNDERPERFORM, TP Eu 22.29, MARKET WEIGHT)
Ayala Land (ALI.PS, P6.50, OUTPERFORM, TP P8.70)
BAE Systems (BAES.L, 341.00p, OUTPERFORM, TP 475.00p, MARKET WEIGHT)
Baloise (BALN.VX, SFr78.45, NEUTRAL, TP SFr95.61, MARKET WEIGHT)
Banco Santander Central Hispano SA (SAN) (SAN.MC, Eu 6.54, OUTPERFORM, TP Eu 11.00, MARKET WEIGHT)
Bank of China Ltd (3988.HK, HK$2.39, NEUTRAL, TP HK$2.32)
BASF (BASF.DE, Eu 25.30, RESTRICTED)
BB&T Corp. (BBT, $26.49, OUTPERFORM [V], TP $36.00)
BBVA (BBVA.MC, Eu 8.42, OUTPERFORM, TP Eu 14.50, MARKET WEIGHT)

Becton Dickinson & Co. (BDX, $65.72, NEUTRAL, TP $84.00)
Beiersdorf (BEIG.DE, Eu 40.73, NEUTRAL, TP Eu 45.00, MARKET WEIGHT)
Belle International Holdings Ltd (1880.HK, HK$3.61, OUTPERFORM [V], TP HK$12.52)
Best Buy (BBY, $23.47, OUTPERFORM, TP $34.00)
BG Group plc (BG.L, 983.50p, OUTPERFORM, TP 1085.00p, MARKET WEIGHT)
Bharti Airtel Ltd (BRTI.BO, Rs737.50, OUTPERFORM, TP Rs950.00, MARKET WEIGHT)
Biogen Idec, Inc. (BIIB, $46.18, NEUTRAL [V], TP $53.00)
BJ Services Co. (BJS, $11.26, UNDERPERFORM, TP $7.00)
BlackRock (BLK, $115.80, NEUTRAL, TP $140.00)
BlueScope Steel (BSL.AX, A$2.99, RESTRICTED)
BMW (BMWG.F, Eu 22.12, OUTPERFORM, TP Eu 32.00, UNDERWEIGHT)
BNP Paribas (BNPP.PA, Eu 39.40, NEUTRAL, TP Eu 42.00, MARKET WEIGHT)
Boeing (BA, $38.74, OUTPERFORM, TP $56.00)
BorgWarner, Inc. (BWA, $20.56, OUTPERFORM, TP $21.00)
Bristol-Myers Squibb (BMY, $22.50, RESTRICTED)
British American Tobacco (BATS.L, 1635.00p, OUTPERFORM, TP 2150.00p, OVERWEIGHT)
British Land (BLND.L, 539.50p, OUTPERFORM, TP 716.00p, MARKET WEIGHT)
Brixton (BXTN.L, 129.50p, OUTPERFORM, TP 235.00p, MARKET WEIGHT)
Broadcom Corp. (BRCM, $17.65, OUTPERFORM [V], TP $20.00)
BT Group (BT.L, 137.70p, NEUTRAL, TP 170.00p, OVERWEIGHT)
Bucher Industries (BUCN.S, SFr96.00, OUTPERFORM, TP SFr297.00, OVERWEIGHT)
Bulgari (BULG.MI, Eu 4.63, NEUTRAL, TP Eu 5.30, OVERWEIGHT)
Bunge Limited (BG, $41.93, RESTRICTED)
Burlington Northern Santa Fe (BNI, $71.53, NEUTRAL, TP $86.00)
Cameron International Corp. (CAM, $20.77, NEUTRAL, TP $22.00)
Capgemini (CAPP.PA, Eu 25.44, OUTPERFORM, TP Eu 36.00, OVERWEIGHT)
Cardinal Health (CAH, $31.42, OUTPERFORM, TP $44.00)
Carphone Warehouse (CPW.L, 89.25p, OUTPERFORM [V], TP 198.00p, UNDERWEIGHT)
Carrefour (CARR.PA, Eu 28.27, NEUTRAL, TP Eu 35.00, MARKET WEIGHT)
Caterpillar Inc. (CAT, $42.21, NEUTRAL, TP $46.00)
Cathay Financial Holding (2882.TW, NT$35.65, OUTPERFORM [V], TP NT$47.50)
Cemex (CX, $8.08, UNDERPERFORM, TP $9.00)
Central Pattana Pcl (CPN.BK, Bt13.20, OUTPERFORM [V], TP Bt18.10)
Cheung Kong Holdings (0001.HK, HK$80.00, OUTPERFORM, TP HK$91.30)
Chevron Corp. (CVX, $78.21, NEUTRAL, TP $68.00)
China Communications Construction Co Ltd (1800.HK, HK$9.40, NEUTRAL [V], TP HK$7.99)
China Construction Bank (0939.HK, HK$4.48, NEUTRAL, TP HK$3.65)
China Life Insurance Co. (2628.HK, HK$23.50, OUTPERFORM [V], TP HK$25.00)
China Merchants Bank - H (3968.HK, HK$15.04, NEUTRAL [V], TP HK$11.55)
China Mobile Limited (0941.HK, HK$81.00, OUTPERFORM [V], TP HK$90.00)
China Railway Construction Corporation (1186.HK, HK$11.48, OUTPERFORM [V], TP HK$13.08)
China Railway Group Ltd (0390.HK, HK$5.30, OUTPERFORM [V], TP HK$6.02)
China Resources Land Ltd (1109.HK, HK$9.00, OUTPERFORM [V], TP HK$11.91)
China Resources Power Holdings (0836.HK, HK$13.38, OUTPERFORM [V], TP HK$23.60)
China Shipping Development (1138.HK, HK$7.98, OUTPERFORM [V], TP HK$11.20)
Cisco Systems Inc. (CSCO, $16.84, NEUTRAL [V], TP $19.00)
Citrix Systems Inc. (CTXS, $23.00, OUTPERFORM [V], TP $39.50)
CNOOC Ltd (0883.HK, HK$7.34, NEUTRAL [V], TP HK$7.10)
CNP Assurances (CNPP.PA, Eu 53.50, NEUTRAL, TP Eu 84.00, MARKET WEIGHT)
Coach, Inc. (COH, $19.87, NEUTRAL [V], TP $19.00)
Cobham (COB.L, 197.70p, NEUTRAL, TP 220.00p, MARKET WEIGHT)
Coca-Cola Enterprises (CCE, $10.20, NEUTRAL, TP $12.00)
Cognizant Technology Solutions Corp. (CTSH, $17.37, OUTPERFORM [V], TP $28.00)
Colt Telecom (COLT.L, 55.25p, NEUTRAL, TP 170.00p, OVERWEIGHT)
Compagnie Financiere Richemont SA (CFR.VX, SFr21.80, OUTPERFORM, TP SFr29.00, OVERWEIGHT)
Compass (CPG.L, 329.50p, NEUTRAL, TP 380.00p, MARKET WEIGHT)
Computer Sciences Corp. (CSC, $31.11, NEUTRAL, TP $38.00)
ConAgra Foods, Inc. (CAG, $14.43, NEUTRAL, TP $21.00)
ConocoPhillips (COP, $51.90, NEUTRAL, TP $60.00)
Continental (CONG.DE, Eu 34.75, NEUTRAL [V], TP Eu 50.00, UNDERWEIGHT)
Cooper Industries (CBE, $27.26, NEUTRAL, TP $21.00)
CRH (CRH.I, Eu 19.86, OUTPERFORM, TP Eu 20.00, UNDERWEIGHT)
CSR (CSR.L, 158.00p, NEUTRAL [V], TP 300.00p, MARKET WEIGHT)
CVS Caremark Corporation (CVS, $27.98, OUTPERFORM [V], TP $40.00)
Daegu Bank (005270.KS, W7,370, OUTPERFORM, TP W8,000)

Dah Sing Banking Group (2356.HK, HK$5.45, OUTPERFORM [V], TP HK$9.00)
Dah Sing Financial (0440.HK, HK$19.38, OUTPERFORM [V], TP HK$36.00)
Daido Steel (5471, ¥298, NEUTRAL [V], TP ¥270, MARKET WEIGHT)
Daimler (DAIGn.DE, Eu 23.90, OUTPERFORM, TP Eu 36.00, UNDERWEIGHT)
Danaher Corporation (DHR, $50.52, NEUTRAL, TP $47.00)
Danone (DANO.PA, Eu 41.86, OUTPERFORM, TP Eu 63.00, MARKET WEIGHT)
Debenhams (DEB.L, 24.50p, NEUTRAL [V], TP 30.00p, UNDERWEIGHT)
Deere & Co. (DE, $36.36, OUTPERFORM, TP $44.00)
Dell Inc. (DELL, $11.13, OUTPERFORM, TP $15.00)
Denso Corp (6902, ¥1,552, NEUTRAL, TP ¥1,600, MARKET WEIGHT)
Derwent London (DLN.L, 708.00p, UNDERPERFORM, TP 696.10p, UNDERWEIGHT)
Deutsche Telekom (DTEGn.F, Eu 10.96, OUTPERFORM, TP Eu 14.00, OVERWEIGHT)
Diageo (DGE.L, 924.00p, OUTPERFORM, TP 1260.00p, OVERWEIGHT)
Diamond Offshore (DO, $68.91, NEUTRAL, TP $93.00)
Digital River Inc. (DRIV, $22.79, NEUTRAL, TP $26.00)
Douglas Holding (DOHG.DE, Eu 31.59, NEUTRAL, TP Eu 29.00, OVERWEIGHT)
DR Horton (DHI, $7.02, NEUTRAL [V], TP $9.00)
Dr. Reddy's Laboratories Limited (REDY.BO, Rs455.90, OUTPERFORM, TP Rs810.00)
Dun & Bradstreet Corp. (DNB, $72.95)
E.I. du Pont de Nemours and Company (DD, $26.17, OUTPERFORM, TP $32.00)
E.ON (EONGn.DE, Eu 26.26, OUTPERFORM, TP Eu 35.00, MARKET WEIGHT)
EADS (EAD.PA, Eu 11.60, UNDERPERFORM [V], TP Eu 9.00, MARKET WEIGHT)
Eaton Corporation (ETN, $43.91, NEUTRAL, TP $48.00)
eBay Inc. (EBAY, $13.91, NEUTRAL, TP $19.00)
EFG Eurobank Ergasias (EFGr.AT, Eu 5.72, OUTPERFORM, TP Eu 16.00, MARKET WEIGHT)
E.I. du Pont de Nemours and Company (DD, $27.11, OUTPERFORM, TP $32.00)
Eli Lilly (LLY, $35.32, NEUTRAL, TP $42.00)
Elisa Corporation (ELI1V.HE, Eu 11.21, NEUTRAL, TP Eu 14.50, OVERWEIGHT)
EMC Corp. (EMC, $10.79, OUTPERFORM, TP $14.00)
Emerson (EMR, $31.70, OUTPERFORM, TP $41.00)
Enagas (ENAG.MC, Eu 14.68, UNDERPERFORM, TP Eu 15.00, MARKET WEIGHT)
Enel (ENEI.MI, Eu 4.26, UNDERPERFORM, TP Eu 5.00, MARKET WEIGHT)
Energias de Portugal (EDP.LS, Eu2.55, NEUTRAL, TP Eu3.55, MARKET WEIGHT)
Energy Development Corporation (EDC.PS, P2.36, OUTPERFORM [V], TP P6.75)
ENI (ENI.MI, Eu 17.89, UNDERPERFORM, TP Eu 19.30, MARKET WEIGHT)
Ericsson (ERIC, $7.37, UNDERPERFORM [V], TP $4.88, MARKET WEIGHT)
Esprit Holdings (0330.HK, HK$48.30, OUTPERFORM [V], TP HK$63.70)
Excelcomindo Pratama PT (EXCL.JK, Rp950.00, OUTPERFORM, TP Rp3000.00)
Express Scripts (ESRX, $58.80, OUTPERFORM [V], TP $79.00)
Exterran Holdings (EXH, $19.84, NEUTRAL, TP $18.00)
ExxonMobil Corporation (XOM, $79.95, NEUTRAL, TP $75.00)
Family Dollar (FDO, $24.63, NEUTRAL, TP $19.00)
Fiat (FIA.MI, Eu 5.06, UNDERPERFORM [V], TP Eu 7.00, UNDERWEIGHT)
First Solar (FSLR, $111.20, OUTPERFORM [V], TP $150.00)
FirstEnergy (FE, $53.09, OUTPERFORM, TP $63.00)
Fluor (FLR, $48.08, OUTPERFORM [V], TP $51.00)
Fondiaria-SAI (FOSA.MI, Eu 13.45, NEUTRAL, TP Eu 25.01, MARKET WEIGHT)
Ford Motor Co. (F, $3.18, NEUTRAL [V], TP $1.00)
Fortum (FUM1V.HE, Eu 14.34, NEUTRAL, TP Eu 18.00, MARKET WEIGHT)
FPL Group (FPL, $45.37, OUTPERFORM, TP $57.00)
France Telecom (FTE.PA, Eu 19.36, NEUTRAL, TP Eu 24.00, OVERWEIGHT)
Franklin Resources (BEN, $58.59, NEUTRAL, TP $64.00)
Fraport (FRAG.DE, Eu 27.67, UNDERPERFORM, TP Eu 40.00, OVERWEIGHT)
Freeport-McMoRan Copper & Gold (FCX, $22.51, OUTPERFORM [V], TP $25.00)
Friends Provident (FP.L, 76.70p, NEUTRAL, TP 108.11p, MARKET WEIGHT)
Galp Energia SGPS (GALP.LS, Eu 7.36, OUTPERFORM [V], TP Eu 12.00, MARKET WEIGHT)
Gamesa (GAM.MC, Eu 13.17, NEUTRAL, TP Eu 16.00, MARKET WEIGHT)
Gas Natural (GAS.MC, Eu 19.38, UNDERPERFORM, TP Eu 26.50, MARKET WEIGHT)
GDF Suez (GSZ.PA, Eu 30.78, OUTPERFORM, TP Eu 41.00, MARKET WEIGHT)
Geberit (GEBN.VX, SFr113.20, NEUTRAL, TP SFr170.00, OVERWEIGHT)
General Dynamics Corporation (GD, $53.11, NEUTRAL, TP $74.00)
General Electric (GE, $16.95, NEUTRAL, TP $17.00)
Generali (GASI.MI, Eu 19.57, UNDERPERFORM, TP Eu 28.00, MARKET WEIGHT)
Giordano Intl. (0709.HK, HK$1.68, OUTPERFORM, TP HK$4.24)
Global Industries, Ltd. (GLBL, $3.55, NEUTRAL [V], TP $3.00)

Globe Telecom Inc (GLO.PS, P770.00, OUTPERFORM, TP P1250.00)
Goldman Sachs Group, Inc. (GS, $66.46, OUTPERFORM, TP $140.00)
Google, Inc. (GOOG, $310.67, OUTPERFORM, TP $400.00)
Great Eagle Hdg. (0041.HK, HK$7.77, OUTPERFORM, TP HK$19.97)
Great Portland Estates (GPOR.L, 236.00p, UNDERPERFORM [V], TP 284.00p, MARKET WEIGHT)
Greentown China Holdings Ltd (3900.HK, HK$2.93, OUTPERFORM [V], TP HK$5.38)
Grupo Financiero Banorte (GFNORTEO, $1.59, NEUTRAL, TP $2.07)
H&E Equipment Services (HEES, $6.43, NEUTRAL [V], TP $9.00)
H.J. Heinz Company (HNZ, $36.56, OUTPERFORM, TP $47.00)
Hammerson Property (HMSO.L, 501.00p, NEUTRAL, TP 877.00p, MARKET WEIGHT)
Hang Lung Group (0010.HK, HK$24.00, OUTPERFORM [V], TP HK$49.59)
Hang Seng Bank (0011.HK, HK$108.60, OUTPERFORM, TP HK$120.00)
Hannover Re (HNRGn.DE, Eu 20.71, NEUTRAL, TP Eu 32.00, MARKET WEIGHT)
Havas (EURC.PA, Eu 1.36, UNDERPERFORM, TP Eu 1.30, UNDERWEIGHT)
Helvetia (HELN.S, SFr191.70, OUTPERFORM, TP SFr385.77, MARKET WEIGHT)
Henkel (HNKG_p.F, Eu 21.81, NEUTRAL, TP Eu 28.00, MARKET WEIGHT)
Hennes & Mauritz (HMb.ST, SKr298.00, OUTPERFORM, TP SKr325.00, UNDERWEIGHT)
Henry Schein, Inc. (HSIC, $34.11, OUTPERFORM, TP $54.00)
Hercules Offshore (HERO, $5.34, NEUTRAL, TP $11.00)
Hermes International (HRMS.PA, Eu 105.32, UNDERPERFORM, TP Eu 67.00, OVERWEIGHT)
Hess Corporation (HES, $47.26, NEUTRAL [V], TP $55.00)
Hewlett-Packard (HPQ, $34.82, NEUTRAL, TP $35.00)
Hexcel Corporation (HXL, $6.74, OUTPERFORM [V], TP $16.00)
High Tech Computer Corp (2498.TW, NT$347.50, OUTPERFORM [V], TP NT$520.00)
HMV Group (HMV.L, 109.00p, UNDERPERFORM, TP 87.00p, UNDERWEIGHT)
Hochtief (HOTG.F, Eu 32.50, OUTPERFORM [V], TP Eu 46.00, OVERWEIGHT)
Holcim (HOLN.VX, SFr61.95, UNDERPERFORM, TP SFr55.00, UNDERWEIGHT)
Holmen (HOLMb.ST, SKr189.00, UNDERPERFORM, TP SKr190.00, MARKET WEIGHT)
Home Retail Group (HOME.L, 230.00p, NEUTRAL [V], TP 162.00p, UNDERWEIGHT)
Hon Hai Precision (2317.TW, NT$68.40, OUTPERFORM [V], TP NT$81.00)
Honeywell International Inc. (HON, $30.78, OUTPERFORM, TP $36.00)
Hopewell Holdings (0054.HK, HK$23.15, OUTPERFORM, TP HK$30.68)
HSBC Holdings (HSBA.L, 724.00p, NEUTRAL, TP 800.00p, MARKET WEIGHT)
Hutchison Telecommunications International Ltd (2332.HK, HK$2.20, OUTPERFORM, TP HK$3.50)
Hyundai Marine & Fire (001450.KS, W13,400, OUTPERFORM [V], TP W18,700)
Iberdrola (IBE.MC, Eu 5.75, NEUTRAL, TP Eu 8.50, MARKET WEIGHT)
ICBC (Asia) Limited (0349.HK, HK$7.83, OUTPERFORM [V], TP HK$11.00)
Idea Cellular Ltd (IDEA.BO, Rs56.80, OUTPERFORM [V], TP Rs60.00, MARKET WEIGHT)
Illinois Tool Works, Inc. (ITW, $31.25, NEUTRAL, TP $31.00)
Imperial Tobacco (IMT.L, 1648.00p, OUTPERFORM, TP 2200.00p, OVERWEIGHT)
Inditex (ITX.MC, Eu 31.67, UNDERPERFORM, TP Eu 24.00, UNDERWEIGHT)
Indra (IDR.MC, Eu 15.83, OUTPERFORM, TP Eu 19.00, OVERWEIGHT)
Industrial & Commercial Bank of China (1398.HK, HK$4.25, NEUTRAL, TP HK$3.50)
Infineon Technologies (IFXGn.DE, Eu .67, NEUTRAL [V], TP Eu .64, MARKET WEIGHT)
Infosys Technologies Ltd. (INFY.BO, Rs1099.00, OUTPERFORM, TP Rs1650.00, MARKET WEIGHT)
ING Group (ING.AS, Eu 7.18, OUTPERFORM, TP Eu 16.50, MARKET WEIGHT)
Inmarsat PLC (ISA.L, 443.75p, OUTPERFORM, TP 540.00p, OVERWEIGHT)
Intel Corp. (INTC, $14.59, OUTPERFORM [V], TP $18.00)
InterContinental Hotels (IHG.L, 559.50p, NEUTRAL, TP 830.00p, MARKET WEIGHT)
International Business Machines (IBM, $82.77, NEUTRAL, TP $90.00)
Intersil Corp. (ISIL, $9.55, NEUTRAL, TP $8.00)
Intesa Sanpaolo (ISP.MI, Eu 2.18, OUTPERFORM, TP Eu 3.20, MARKET WEIGHT)
Invesco (IVZ.L, 626.50p)
Italcementi (ITAI.MI, Eu 8.43, NEUTRAL, TP Eu 10.00, UNDERWEIGHT)
ITT Corporation, Inc. (ITT, $42.35, NEUTRAL, TP $44.00)
ITV (ITV.L, 36.00p, NEUTRAL [V], TP 34.00p, UNDERWEIGHT)
Jabil Circuit Inc. (JBL, $6.32, OUTPERFORM [V], TP $8.50)
Jacobs Engineering (JEC, $45.26, OUTPERFORM, TP $45.00)
JB Hunt Transport Services (JBHT, $23.53, NEUTRAL [V], TP $26.00)
JC Penney (JCP, $19.58, NEUTRAL [V], TP $24.00)
JCDecaux S.A. (JCDX.PA, Eu 12.09, UNDERPERFORM, TP Eu 11.50, UNDERWEIGHT)
JFE Holdings Inc (5411, ¥2,550, NEUTRAL [V], TP ¥2,150, MARKET WEIGHT)
Johnson & Johnson (JNJ, $57.81, NEUTRAL, TP $66.00)
Johnson Controls, Inc. (JCI, $18.32, OUTPERFORM, TP $29.00)
JPMorgan Chase & Co. (JPM, $28.63, OUTPERFORM [V], TP $50.00)

Juniper Networks (JNPR, $16.96, NEUTRAL [V], TP $20.00)
K + S (SDFG.DE, Eu 36.83, OUTPERFORM [V], TP Eu 60.00, OVERWEIGHT)
KABA (KABN.S, SFr264.00, OUTPERFORM, TP SFr411.00, OVERWEIGHT)
Kazakhmys Plc (KAZ.L, 246.25p, OUTPERFORM [V], TP 820.00p, OVERWEIGHT)
KBC (KBC.BR, Eu 26.85, OUTPERFORM, TP Eu 43.00, MARKET WEIGHT)
Kellogg Company (K, $42.15, OUTPERFORM, TP $57.00)
Kesa Electricals (KESA.L, 102.00p, UNDERPERFORM [V], TP 55.00p, UNDERWEIGHT)
Kingfisher (KGF.L, 137.90p, NEUTRAL [V], TP 150.00p, UNDERWEIGHT)
Kingspan (KSP.I, Eu 3.08, NEUTRAL [V], TP Eu 4.00, UNDERWEIGHT)
KLA-Tencor Corp. (KLAC, $20.49, UNDERPERFORM [V], TP $16.00)
Kobe Steel (5406, ¥162, NEUTRAL, TP ¥150, MARKET WEIGHT)
Komax (KOMn.S, SFr49.00, NEUTRAL, TP SFr139.00, OVERWEIGHT)
Komercni Banka (BKOMsp.PR, Kc3020.00, NEUTRAL, TP Kc4200.00)
Kone Corporation (KNEBV.HE, Eu 14.86, OUTPERFORM, TP Eu 31.25, OVERWEIGHT)
Koninklijke DSM NV (DSMN.AS, Eu 18.31, OUTPERFORM, TP Eu 27.00, UNDERWEIGHT)
Korea Exchange Bank (004940.KS, W7,000, RESTRICTED)
KPN (KPN.AS, Eu 10.49, NEUTRAL, TP Eu 12.00, OVERWEIGHT)
Kraft Foods, Inc. (KFT, $26.74, NEUTRAL, TP $33.00)
Krung Thai Bank (KTB.BK, Bt3.64, OUTPERFORM, TP Bt5.60)
Kuehne + Nagel (KNIN.VX, SFr64.45, NEUTRAL, TP SFr70.00, UNDERWEIGHT)
L-3 Communications (LLL, $67.59, NEUTRAL, TP $95.00)
Lab Corporation of America (LH, $61.33, OUTPERFORM, TP $80.00)
Lafarge (LAFP.PA, Eu 44.81, UNDERPERFORM, TP Eu 55.00, UNDERWEIGHT)
Land Securities (LAND.L, 921.50p, NEUTRAL, TP 1167.00p, MARKET WEIGHT)
Legal & General (LGEN.L, 72.00p, NEUTRAL, TP 105.30p, MARKET WEIGHT)
Legg Mason (LM, $19.16, UNDERPERFORM [V], TP $20.00)
Legrand SA (LEGD.PA, Eu 14.65, UNDERPERFORM, TP Eu 11.50, UNDERWEIGHT)
LG Dacom Corp (015940.KS, W18,150, OUTPERFORM, TP W26,800)
Liberty International (LII.L, 505.00p, UNDERPERFORM, TP 657.00p, MARKET WEIGHT)
Lifestyle International Holdings Ltd (1212.HK, HK$6.40, OUTPERFORM [V], TP HK$19.15)
LIG Insurance Co Ltd (002550.KS, W12,550, OUTPERFORM [V], TP W20,300)
Lincare Holdings (LNCR, $23.76, NEUTRAL, TP $32.00)
Lincoln Natl (LNC, $15.59, OUTPERFORM, TP $30.00)
Linde (LING.F, Eu 55.12, OUTPERFORM, TP Eu 87.00, UNDERWEIGHT)
Linear Technology Corp. (LLTC, $22.82, OUTPERFORM, TP $25.00)
Lockheed Martin (LMT, $75.86, NEUTRAL, TP $100.00)
Logitech International S.A. (LOGN.VX, SFr15.22, NEUTRAL [V], TP SFr24.00, OVERWEIGHT)
L'Oreal (OREP.PA, Eu 60.58, NEUTRAL, TP Eu 67.00, MARKET WEIGHT)
Lorillard Inc. (LO, $57.89, OUTPERFORM, TP $82.00)
Lotte Shopping (023530.KS, W194,000, OUTPERFORM, TP W280,000)
Lupin Ltd (LUPN.BO, Rs547.95, NEUTRAL, TP Rs620.00)
LVMH (LVMH.PA, Eu 46.86, OUTPERFORM, TP Eu 74.00, OVERWEIGHT)
Man Group (EMG.L, 253.75p, OUTPERFORM, TP 485.00p, MARKET WEIGHT)
Manila Electric (Meralco) - A (ABC.PS, P59.00)
Manila Water Company (MWC.PS, P13.00, OUTPERFORM, TP P27.00)
Marathon Oil Corp (MRO, $24.71, OUTPERFORM, TP $31.00)
Marks & Spencer (MKS.L, 228.25p, UNDERPERFORM, TP 160.00p, UNDERWEIGHT)
Maruti Suzuki India Ltd (MRTI.BO, Rs508.85, OUTPERFORM, TP Rs635.03)
Mattel, Inc. (MAT, $14.53, OUTPERFORM, TP $26.00)
Maxim Integrated Products (MXIM, $12.70, NEUTRAL, TP $14.00)
McDermott International (MDR, $8.76, NEUTRAL [V], TP $12.00)
McDonald's Corp (MCD, $60.69, NEUTRAL, TP $60.00)
Mechel (MTL.N, $4.53, NEUTRAL [V], TP $12.00)
Medtronic (MDT, $30.18, NEUTRAL, TP $37.00)
Meggitt (MGGT.L, 151.25p, OUTPERFORM [V], TP 250.00p, MARKET WEIGHT)
MEMC Electronic Materials Inc. (WFR, $14.75, NEUTRAL [V], TP $12.50)
Merck & Co. (MRK, $26.60, NEUTRAL, TP $30.00)
MetLife, Inc. (MET, $29.39, OUTPERFORM, TP $40.00)
Metro (MEOG.F, Eu 27.95, NEUTRAL, TP Eu 30.00, MARKET WEIGHT)
Metropolitan Bank & Trust (MBT.PS, P22.75, OUTPERFORM [V], TP P38.00)
MGM Mirage (MGM, $11.50, NEUTRAL [V], TP $10.00)
Michelin (MICP.PA, Eu 37.98, OUTPERFORM, TP Eu 47.00, UNDERWEIGHT)
Microchip Technology Inc. (MCHP, $20.17, RESTRICTED [V])
Micron Technology Inc. (MU, $1.90, OUTPERFORM [V], TP $10.00)
Microsoft Corp. (MSFT, $19.04, OUTPERFORM, TP $33.00)

Mindray Medical International Ltd (MR.N, $17.74, OUTPERFORM [V], TP $36.00)
Mobistar (MSTAR.BR, Eu 52.63, OUTPERFORM, TP Eu 62.00, OVERWEIGHT)
Molex Inc. (MOLX, $13.20, NEUTRAL, TP $11.00)
Mondi (MNDI.L, 178.00p, UNDERPERFORM [V], TP 215.00p, MARKET WEIGHT)
Moneysupermarket.com (MONY.L, 44.75p, OUTPERFORM [V], TP 100.00p, UNDERWEIGHT)
Mosaic Co (MOS, $31.46, OUTPERFORM [V], TP $70.00)
Motorola Inc. (MOT, $4.17, UNDERPERFORM [V], TP $5.00, MARKET WEIGHT)
M-real (MRLBV.HE, Eu .92, NEUTRAL [V], TP Eu 1.15, MARKET WEIGHT)
Munich Re (MUVGn.DE, Eu 118.19, NEUTRAL, TP Eu 160.00, MARKET WEIGHT)
Murphy Oil Corp. (MUR, $42.78, UNDERPERFORM, TP $52.00)
National Bank of Greece (NBGr.AT, Eu 13.10, OUTPERFORM, TP Eu 30.00, MARKET WEIGHT)
National Grid (NG.L, 637.50p, UNDERPERFORM, TP 700.00p, MARKET WEIGHT)
National Oilwell Varco (NOV, $24.60, OUTPERFORM [V], TP $30.00)
National Semiconductor Corp. (NSM, $11.03, NEUTRAL [V], TP $9.00)
Nestle (NESN.VX, SFr40.80, OUTPERFORM, TP SFr54.00, MARKET WEIGHT)
NetApp Inc. (NTAP, $13.56, NEUTRAL [V], TP $13.00)
News Corporation (NWSA, $7.78, NEUTRAL, TP $11.00)
Nike Inc. (NKE, $48.19, OUTPERFORM, TP $60.00)
Nippon Steel (5401, ¥296, NEUTRAL, TP ¥270, MARKET WEIGHT)
Nokia (NOK1V.HE, Eu 11.25, NEUTRAL, TP Eu 10.00, MARKET WEIGHT)
Nokia Corporation (NOK, $15.31, NEUTRAL, TP $22.88, MARKET WEIGHT)
Nordstrom (JWN, $12.13, OUTPERFORM [V], TP $22.00)
Norske Skog (NSG.OL, NKr13.30, NEUTRAL [V], TP NKr18.70, MARKET WEIGHT)
Northrop Grumman Corporation (NOC, $40.33, OUTPERFORM, TP $71.00)
Northumbrian Water (NWG.L, 251.50p, NEUTRAL, TP 281.00p, MARKET WEIGHT)
Nucor (NUE, $43.06, OUTPERFORM [V], TP $50.00)
Occidental Petroleum (OXY, $54.77, OUTPERFORM [V], TP $75.00)
Oceaneering Intl, Inc. (OII, $25.48, NEUTRAL [V], TP $27.00)
Oil States International (OIS, $18.47, NEUTRAL [V], TP $21.00)
Omnicom Group, Inc. (OMC, $27.15, NEUTRAL, TP $32.00)
OneSteel (OST.AX, A$2.08, OUTPERFORM, TP A$4.65)
Oracle Corporation (ORCL, $16.45, NEUTRAL, TP $15.50)
Oshkosh Corporation (OSK, $7.83, NEUTRAL, TP $8.00)
Outokumpu (OUT1V.HE, Eu 7.68, NEUTRAL [V], TP Eu 13.00, OVERWEIGHT)
Oversea-Chinese Banking Corporation (OCBC.SI, S$5.20, NEUTRAL, TP S$5.00)
Paccar Inc (PCAR, $26.85, NEUTRAL, TP $29.00)
Parker Hannifin Corporation (PH, $36.66, NEUTRAL, TP $44.00)
Partners Group (PGHN.S, SFr71.20, NEUTRAL, TP SFr98.00, MARKET WEIGHT)
Paychex (PAYX, $25.27, NEUTRAL, TP $32.00)
Pennon Group (PNN.L, 453.00p, OUTPERFORM, TP 667.00p, MARKET WEIGHT)
Pepsi Bottling Group (PBG, $18.49, NEUTRAL, TP $24.00)
PepsiAmericas (PAS, $17.93, NEUTRAL, TP $20.00)
PepsiCo, Inc. (PEP, $52.42, OUTPERFORM, TP $67.00)
Petroleum Geo Services (PGS.OL, NKr26.90, NEUTRAL [V], TP NKr35.00, MARKET WEIGHT)
Pfizer (PFE, $16.63, NEUTRAL, TP $19.00)
PG&E Corporation (PCG, $36.67, OUTPERFORM, TP $47.00)
Philippine Long Distance Telephone (TEL.PS, P2185.00, OUTPERFORM, TP P2600.00)
Philips (PHG.AS, Eu 13.65, OUTPERFORM, TP Eu 21.00, UNDERWEIGHT)
PICC Property & Casualty (2328.HK, HK$3.89, OUTPERFORM [V], TP HK$5.00)
Ping An Insurance (2318.HK, HK$37.05, OUTPERFORM [V], TP HK$47.00)
Polo Ralph Lauren (RL, $42.74, OUTPERFORM, TP $60.00)
Porsche (PSHG_p.F, Eu 47.77, OUTPERFORM [V], TP Eu 90.00, UNDERWEIGHT)
PPG Industries, Inc. (PPG, $43.55, NEUTRAL, TP $55.00)
PPR (PRTP.PA, Eu 39.67, NEUTRAL [V], TP Eu 39.00, UNDERWEIGHT)
Praxair Inc. (PX, $55.43, NEUTRAL, TP $68.00)
Precision Castparts (PCP, $54.59, OUTPERFORM, TP $79.00)
priceline.com Inc. (PCLN, $62.93, OUTPERFORM [V], TP $110.00)
Pride International Inc. (PDE, $16.20, NEUTRAL, TP $26.00)
ProSiebenSat.1 (PSMG_p.DE, Eu 1.44, NEUTRAL [V], TP Eu 2.70, UNDERWEIGHT)
Prudential (PRU.L, 347.00p, NEUTRAL, TP 472.49p, MARKET WEIGHT)
Public Svc Ent (PEG, $29.23, OUTPERFORM, TP $39.00)
Publicis (PUBP.PA, Eu 18.14, OUTPERFORM, TP Eu 29.00, UNDERWEIGHT)
Pulte (PHM, $10.20, NEUTRAL [V], TP $11.00)
Pusan Bank (005280.KS, W6,500, OUTPERFORM [V], TP W7,000)
Q-Cells (QCEG.DE, Eu 17.90, OUTPERFORM [V], TP Eu 28.00, MARKET WEIGHT)

Qiagen (QGEN.DE, Eu 12.12, OUTPERFORM, TP Eu 14.60, OVERWEIGHT)
QinetiQ (QQ.L, 164.75p, OUTPERFORM, TP 240.00p, MARKET WEIGHT)
QUALCOMM Inc. (QCOM, $33.81, OUTPERFORM [V], TP $45.00, MARKET WEIGHT)
Quanta Services (PWR, $17.96, OUTPERFORM [V], TP $25.00)
Rayonier (RYN, $28.88, OUTPERFORM, TP $45.00)
Raytheon Company (RTN, $49.94, NEUTRAL, TP $61.00)
Reckitt Benckiser (RB.L, 2454.00p, OUTPERFORM, TP 3200.00p, MARKET WEIGHT)
Red Electrica (REE.MC, Eu 35.50, OUTPERFORM, TP Eu 42.00, MARKET WEIGHT)
Reed Elsevier plc (REL.L, 463.75p, OUTPERFORM, TP 680.00p, UNDERWEIGHT)
Reliance Industries (RELI.BO, Rs1338.05, NEUTRAL, TP Rs1969.00)
REN (RENE.LS, Eu 2.47, UNDERPERFORM, TP Eu 2.45, MARKET WEIGHT)
RenaissanceRe Holdings (RNR, $46.63, OUTPERFORM, TP $59.00)
Renault (RENA.PA, Eu 17.30, UNDERPERFORM, TP Eu 17.00, UNDERWEIGHT)
Renewable Energy (REC.OL, NKr55.20, OUTPERFORM [V], TP NKr92.00, MARKET WEIGHT)
Repsol YPF SA (REP.MC, Eu 14.91, RESTRICTED)
Resona Holdings (8308, ¥139,900, OUTPERFORM [V], TP ¥165,000, OVERWEIGHT)
Rexam (REX.L, 342.00p, OUTPERFORM, TP 415.00p, MARKET WEIGHT)
Reynolds American Inc. (RAI, $40.01, NEUTRAL, TP $50.00)
Rezidor Hotel Group (REZT.ST, SKr18.00, NEUTRAL [V], TP SKr30.00, MARKET WEIGHT)
Robinsons Land Corporation (RLC.PS, P5.90, OUTPERFORM [V], TP P9.01)
Rockwell Automation (ROK, $28.38, NEUTRAL, TP $25.00)
Rohm and Haas Company (ROH, $67.69, NEUTRAL, TP $78.00)
Rosneft (ROSN.RTS, $4.18, UNDERPERFORM [V], TP $4.30)
Ross Stores (ROST, $27.56, NEUTRAL, TP $22.00)
RSA (RSA.L, 134.30p, NEUTRAL, TP 163.00p, MARKET WEIGHT)
RWE (RWEG.F, Eu63.51, NEUTRAL, TP Eu71.00, MARKET WEIGHT)
Sa Sa International Holding (0178.HK, HK$1.70, OUTPERFORM, TP HK$1.97)
Salesforce.com Inc. (CRM, $30.51, NEUTRAL [V], TP $25.00)
Salzgitter (SZGG.DE, Eu 48.77, OUTPERFORM, TP Eu 124.00, OVERWEIGHT)
Samsung Electronics (005930.KS, W472,000, OUTPERFORM, TP W520,000)
SandRidge Energy, Inc. (SD, $6.28, NEUTRAL [V], TP $11.00)
Sandvik (SAND.ST, SKr47.80, NEUTRAL, TP SKr59.00, UNDERWEIGHT)
SAP (SAPG.F, Eu 24.63, OUTPERFORM, TP Eu 32.00, OVERWEIGHT)
Sara Lee Corporation (SLE, $9.34, NEUTRAL, TP $12.50)
Sberbank (SBER.RTS, $.83, OUTPERFORM, TP $1.70)
SBM OFFSHORE NV (SBMO.AS, Eu 10.59, NEUTRAL, TP Eu 18.00, MARKET WEIGHT)
SCA (SCAb.ST, SKr63.75, NEUTRAL, TP SKr75.00, MARKET WEIGHT)
Schering-Plough (SGP, $16.97, OUTPERFORM, TP $22.00)
Schlumberger (SLB, $42.81, NEUTRAL, TP $40.00)
Schneider (SCHN.PA, Eu 52.35, NEUTRAL, TP Eu 56.00, UNDERWEIGHT)
Schroders (SDR.L, 845.00p, NEUTRAL [V], TP 900.00p, MARKET WEIGHT)
Scor (SCOR.PA, Eu 15.44, OUTPERFORM, TP Eu 21.60, MARKET WEIGHT)
Scottish & Southern Energy (SSE.L, 1105.00p, NEUTRAL, TP 1300.00p, MARKET WEIGHT)
Segro Plc (SGRO.L, 245.25p, NEUTRAL, TP 375.00p, MARKET WEIGHT)
Severn Trent (SVT.L, 1091.00p, UNDERPERFORM, TP 1319.00p, MARKET WEIGHT)
Shandong Weigao Group Medical (8199.HK, HK$11.00, OUTPERFORM [V], TP HK$19.00)
Shaw Group, Inc. (SGR, $18.38, OUTPERFORM [V], TP $22.00)
Shinhan Financial Group (055550.KS, W32,000, NEUTRAL, TP W34,000)
Siam City Bank Pub Co Ltd (SCIB.BK, Bt6.90, OUTPERFORM, TP Bt8.70)
Siemens (SIEGn.DE, Eu 47.15, OUTPERFORM, TP Eu 70.00, UNDERWEIGHT)
Simon Property Group, Inc. (SPG, $49.65, OUTPERFORM, TP $95.00)
Sims Metal Management Limited (SGM.AX, A$15.60, OUTPERFORM, TP A$16.00)
SK Broadband Co Ltd (033630.KQ, W5,090, OUTPERFORM, TP W9,600)
SK Telecom (017670.KS, W203,500, OUTPERFORM, TP W230,000)
Smith International, Inc. (SII, $24.33, OUTPERFORM [V], TP $24.00)
Smurfit Kappa (SKG.I, Eu 1.50, OUTPERFORM [V], TP Eu 4.30, MARKET WEIGHT)
Snam Rete Gas (SRG.MI, Eu 3.84, NEUTRAL, TP Eu 4.60, MARKET WEIGHT)
Societe Generale (SOGN.PA, Eu 35.38, OUTPERFORM [V], TP Eu 47.00, MARKET WEIGHT)
Sodexo (EXHO.PA, Eu 38.90, NEUTRAL, TP Eu 41.00, MARKET WEIGHT)
Soitec (SOIT.PA, Eu 3.42, NEUTRAL [V], TP Eu 4.60, MARKET WEIGHT)
SPX Corporation (SPW, $34.26, NEUTRAL, TP $41.00)
SSAB (SSABa.ST, SKr62.75, NEUTRAL [V], TP SKr120.00, OVERWEIGHT)
St. Jude Medical (STJ, $30.58, NEUTRAL, TP $31.00)
Standard Chartered (STAN.L, 749.00p, NEUTRAL, TP 700.00p, MARKET WEIGHT)
Standard Life (SL.L, 265.00p, UNDERPERFORM, TP 257.71p, MARKET WEIGHT)

Staples (SPLS, $16.94, OUTPERFORM, TP $24.00)
StatoilHydro ASA (STL.OL, NKr113.20, UNDERPERFORM, TP NKr120.00, MARKET WEIGHT)
STMicroelectronics (STM.PA, Eu 4.92, UNDERPERFORM, TP Eu 4.40, MARKET WEIGHT)
Stora Enso (STERV.HE, Eu 5.64, OUTPERFORM, TP Eu 8.75, MARKET WEIGHT)
Stryker Corporation (SYK, $39.35, NEUTRAL, TP $45.00)
Sulzer (SUN.S, SFr59.85, NEUTRAL [V], TP SFr140.00, OVERWEIGHT)
Sumitomo Mitsui Financial Group (8316, ¥352,000, OUTPERFORM, TP ¥550,000, OVERWEIGHT)
Sumitomo Trust & Banking (8403, ¥465, OUTPERFORM [V], TP ¥648, OVERWEIGHT)
Sun Hung Kai Properties (0016.HK, HK$65.35, OUTPERFORM [V], TP HK$84.06)
Sun Pharmaceuticals Industries Limited (SUN.BO, Rs1086.25, OUTPERFORM, TP Rs1370.00)
SunPower Corp. (SPWRA, $30.54, NEUTRAL [V], TP $35.00)
Swatch Group (UHR.VX, SFr145.80, OUTPERFORM, TP SFr250.00, OVERWEIGHT)
Swire Pacific 'A' (0019.HK, HK$55.00, OUTPERFORM, TP HK$75.90)
Swiss Life (SLHn.VX, SFr73.65, NEUTRAL, TP SFr175.00, MARKET WEIGHT)
Swiss Re (RUKN.VX, SFr47.80, OUTPERFORM, TP SFr85.00, MARKET WEIGHT)
Swisscom (SCMN.VX, SFr338.50, OUTPERFORM, TP SFr460.00, OVERWEIGHT)
Symantec Corporation (SYMC, $12.33, OUTPERFORM, TP $20.00)
Syngenta (SYNN.VX, SFr205.60, OUTPERFORM, TP SFr275.00, UNDERWEIGHT)
Synthes (SYST.VX, SFr137.50, OUTPERFORM, TP SFr165.00, OVERWEIGHT)
Taiwan Semiconductor Manufacturing (2330.TW, NT$43.45, OUTPERFORM, TP NT$50.00)
Tata Consultancy Services (TCS.BO, Rs469.30, OUTPERFORM, TP Rs725.00, MARKET WEIGHT)
Tata Steel Ltd (TISC.BO, Rs226.70, OUTPERFORM [V], TP Rs320.00)
Tele2 (TEL2b.ST, SKr69.25, NEUTRAL, TP SKr115.00, OVERWEIGHT)
Telefonica (TEF.MC, Eu 16.04, OUTPERFORM, TP Eu 20.00, OVERWEIGHT)
Telekom Austria (TELA.VI, Eu 11.45, NEUTRAL, TP Eu 15.00, OVERWEIGHT)
TeliaSonera (TLSN.ST, SKr37.40, NEUTRAL, TP SKr54.00, OVERWEIGHT)
Teradyne Inc. (TER, $3.94, NEUTRAL, TP $7.00)
Terex Corporation (TEX, $15.87, NEUTRAL [V], TP $12.00)
Terna (TRN.MI, Eu 2.24, NEUTRAL, TP Eu 2.78, MARKET WEIGHT)
Tesco (TSCO.L, 327.00p, OUTPERFORM, TP 400.00p, MARKET WEIGHT)
Texas Instruments Inc. (TXN, $15.47, NEUTRAL, TP $12.00)
Textron (TXT, $14.57, NEUTRAL, TP $18.00)
The Coca-Cola Company (KO, $44.97, NEUTRAL, TP $55.00)
The Directv Group Inc (DTV, $22.98, NEUTRAL, TP $22.00)
The Hershey Company (HSY, $35.38, NEUTRAL, TP $32.00)
The Patterson Companies (PDCO, $17.71, NEUTRAL, TP $18.00)
Thomson Reuters PLC (TRIL.L, 1364.00p, NEUTRAL, TP 1300.00p)
Thyssen Krupp AG (TKAG.F, Eu 16.80, OUTPERFORM, TP Eu 44.00, OVERWEIGHT)
Tietoenator (TIE1V.HE, Eu 8.04, NEUTRAL, TP Eu 12.00, OVERWEIGHT)
Tiffany & Co. (TIF, $22.40, NEUTRAL, TP $20.00)
TM International Snd Bhd (TMIT.KL, RM3.54, OUTPERFORM [V], TP RM7.25)
TNT (TNT.AS, Eu 13.14, OUTPERFORM, TP Eu 24.50, MARKET WEIGHT)
Tokyo Steel Mfg. (5423, ¥895, NEUTRAL, TP ¥910, MARKET WEIGHT)
Transocean Inc. (RIG, $57.22, OUTPERFORM, TP $108.00)
UBI Banca (UBI.MI, Eu 11.46, NEUTRAL, TP Eu 13.40, MARKET WEIGHT)
UBS (UBSN.VX, SFr14.20, NEUTRAL [V], TP SFr21.00, MARKET WEIGHT)
Unicredit (CRDI.MI, Eu 1.52, OUTPERFORM, TP Eu 2.70, MARKET WEIGHT)
Unilever PLC (ULVR.L, 1442.00p, UNDERPERFORM, TP 1820.00p, MARKET WEIGHT)
Union Fenosa (UNF.MC, Eu 17.50, NEUTRAL, TP Eu 18.33, MARKET WEIGHT)
United Business Media (UBM.L, 455.50p, OUTPERFORM, TP 750.00p, UNDERWEIGHT)
United Overseas Bank (UOBH.SI, S$13.28, OUTPERFORM, TP S$14.75)
United Parcel Service Inc. (UPS, $51.85, NEUTRAL, TP $57.00)
United States Steel Group (X, $37.17, NEUTRAL [V], TP $40.00)
United Technologies (UTX, $49.63, OUTPERFORM, TP $54.00)
United Utilities (UU.L, 595.00p, NEUTRAL, TP 671.00p, MARKET WEIGHT)
UnitedHealth Group (UNH, $23.78, NEUTRAL, TP $25.00)
UPM-Kymmene (UPM1V.HE, Eu 9.12, NEUTRAL, TP Eu 12.20, MARKET WEIGHT)
URS Corporation (URS, $37.68, OUTPERFORM [V], TP $40.00)
UST Inc. (UST, $68.61, NEUTRAL, TP $69.50)
Valora (VALN.S, SFr147.60, UNDERPERFORM, TP SFr200.00, OVERWEIGHT)
Vedanta Resources PLC (VED.L, 689.00p, UNDERPERFORM [V], TP 1050.00p, OVERWEIGHT)
Veolia Environnement (VIE.PA, Eu 18.66, NEUTRAL, TP Eu 20.00, MARKET WEIGHT)
Verbund (VERB.VI, Eu 31.79, UNDERPERFORM, TP Eu 30.00, MARKET WEIGHT)
Versatel (VTWGn.DE, Eu 8.85, NEUTRAL [V], TP Eu 22.50, OVERWEIGHT)
VF Corporation (VFC, $51.00, OUTPERFORM, TP $60.00)

Vienna Insurance Group (VIGR.VI, Eu 22.00, OUTPERFORM, TP Eu 55.00, MARKET WEIGHT)
Vinci (SGEF.PA, Eu 29.67, OUTPERFORM, TP Eu 54.00, OVERWEIGHT)
VMware Inc. (VMW, $23.73, UNDERPERFORM [V], TP $20.00)
Vodafone Group (VOD.L, 128.50p, NEUTRAL, TP 160.00p, OVERWEIGHT)
Volkswagen (VOWG.F, Eu 307.50, UNDERPERFORM [V], TP Eu 115.00, UNDERWEIGHT)
Vozrozhdenie (VZRZ.RTS, $9.53, OUTPERFORM, TP $24.00)
Weatherford International, Inc. (WFT, $10.31, OUTPERFORM, TP $12.00)
Wells Fargo & Company (WFC, $26.07, OUTPERFORM, TP $38.00)
Western Gas Partners, L.P. (WES, $12.28, RESTRICTED [V])
Western Union (WU, $13.70, NEUTRAL, TP $23.00)
Wharf Holdings (0004.HK, HK$19.34, OUTPERFORM [V], TP HK$28.06)
Wilmar International Ltd (WLIL.SI, S$2.89, OUTPERFORM [V], TP S$3.30)
WPP (WPP.L, 370.75p, OUTPERFORM, TP 610.00p, UNDERWEIGHT)
Wyeth (WYE, $35.26, OUTPERFORM, TP $45.00)
Wynn Resorts (WYNN, $40.76, NEUTRAL [V], TP $45.00)
Xilinx (XLNX, $17.27, NEUTRAL [V], TP $18.00)
XTO Energy Inc. (XTO, $35.84, OUTPERFORM, TP $51.00)
Yahoo Inc. (YHOO, $12.73, NEUTRAL [V], TP $14.00)
Yum! Brands, Inc. (YUM, $28.13, OUTPERFORM, TP $36.00)
Zimmer Holdings, Inc. (ZMH, $38.79, NEUTRAL, TP $48.00)
Zurich Financial Services (ZURN.VX, SFr233.70, OUTPERFORM, TP SFr334.00, MARKET WEIGHT)

Companies mentioned not covered in the report

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