BARCLAYS

Equity Research

European Equity Strategy

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European Equity Strategy Chart Pack

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PLEASE SEE ANALYST CERTIFICATIONS AND IMPORTANT DISCLOSURES BEGINNING ON SLIDE 190.

Don’t chase the rally

Cautious positioning suggests many risks are discounted…

Equities are back to the top of the ytd range but we advise against chasing the rally. While cautious positioning suggests many risks are discounted, fundamentals have not improved much and a year-end rally is mostly contingent on a resolution of the trade/Brexit deadlock. Positive surprises are of course possible, but not our base case, and we expect uncertainty to remain a drag on activity. Manufacturing weakness is spreading to services in Europe and China, and US recession fears are rising. Monetary stimulus and resilient consumer should keep the economy afloat, but risks to the growth outlook remain tilted to the downside. Weak Q3 results may not be a surprise given the lowered expectations, but the bar for Q4 and for 2020 is higher. We hold a defensive sector allocation and keep a Value bias - the style rotation could have legs as long as bond yields stabilise.

Equities are resilient but unloved. Equity have rebounded despite weakening fundamentals and without much inflows. Investors used the ytd rally to de-risk and add to relative safe havens, bonds and cash. Last 12-month global equity outflows amount to a significant 3% of AUM, almost half of the outflows seen during the last downturn. Macro HFs/CTAs/vol targeting funds have reduced their shorts recently but are not aggressively long, and sentiment indicators are cautious. Not everyone is bearish, though, as buybacks announcements remain steady and US retail is still invested in equities.

Safe assets are expensive. Growth outperformed Value almost continuously in the last decade due to superior EPS delivery and falling bond yields. However, the impressive leg-up in Growth performance ytd was mostly due to P/E re-rating and exacerbated by the flight to safety. The common wisdom is that the space will work as a recessionary hedge, but we disagree. On the contrary, our view is that crowded positioning, extreme valuations and earnings cyclicality make Growth/Quality stocks more vulnerable to a downturn than Value.

The stabilisation in bond yields helps Value. As the bond market seems to be pricing in a lot of macro negativity and policy easing, we believe that it might not take much for bond yields to find a floor. While a significant pick-up in yields seems unlikely, a stabilisation could be enough for the Value rotation to carry-on.

…but equity/macro decoupling is unsettling – a pause is warranted

- **Trade war and Brexit are yet to be fixed**. Optimism has come back on these two fronts recently and October could see further progress, or not. Impeachment noise and falling approval ratings on Trump's handling of the economy suggest that the President may favour an interim trade deal over escalation. In the UK, PM Johnson is facing a narrowing range of options to deliver his promise to leave the EU by 31 October. As a no-deal will be stopped by parliament, the government might be willing to compromise and negotiate an agreement with the EU. While we acknowledge the potential for positive surprises, Barclays' base case sees little likelihood of a full resolution of the trade and Brexit issues in the near term.
- **Risks to the growth outlook are known, but still tilted to the downside**. Activity weakness is broadening in Europe, as the drag from manufacturing is spreading to services. ECB stimulus coupled with easing fiscal policies support domestic demand but may not fully mitigate the softening external demand. Chinese growth is stabilising at a low level and while policy is turning more pro-growth oriented, easing is more selective than it was in 2016 - less growth and less stimulus is becoming the new norm. In the US, recession fears are rising given inverted yield curves, falling NIPA margins and softening labour market. We believe easing Fed policy, well behaved credit markets and resilient consumer will keep the economy afloat, but late cycle fears are unlikely to dissipate anytime soon.
- **Earnings downgrades are not over.** Q3 estimates have been lowered materially and do not look demanding, but the bar for Q4 and for 2020 is higher. The sharp de-rating of H2'18 allowed equities to rebound ytd despite negative EPS revisions, but as P/E multiples have now normalised, further meaningful market upside is contingent on improving earnings momentum, which may not happen quickly.
- **Equity valuations are underpinned by depressed interest rates.** Stocks have re-rated back to fair value, but valuations are not excessive compared to the other asset classes. Depressed bond yields reinforce the attractiveness of equities, as long as activity holds. Credit market fundamentals are not getting any better, but we generally find corporate balance sheets to be in good shape, while debt affordability is elevated.

Value rotation helps unloved Europe

- **Europe is under owned but Value rotation helps.** The region trailed US equities in seven of the last ten years, mostly due to weaker earnings. Weak domestic growth, declining Banks profitability, lack of Tech, over-reliance on the 'old economy', messy politics and trade exposure have turned the region into a consensus UW. European equity funds have seen almost uninterrupted outflows for more than a year now, and US investors have turned net sellers ytd. However, European equities are performing in line with the US ytd, and benefited from the recent rotation to Value recently.
- **Renewed ECB easing is welcome but fiscal expansion will not happen quickly.** Amid weakening external demand, domestic spending is holding up as labour market, financing conditions and fiscal policy are supportive of the consumer. ECB announced a comprehensive package (lower rates, tiering and re-start of QE) in September, which should help, and budgets are turning more accommodative. But willingness to deploy significant fiscal easing is still low in Germany.
- **MW Europe vs. US:** SXXP underperformed SPX during the summer, but outperformed in September, helped by the broader rotation to Value. European relative valuations are attractive and the region is consensus UW, but catalysts for a sustainable reversal are missing, in our view. Reducing Brexit- and trade-related uncertainty would likely be triggers for investors to add exposure, but we are not there yet.
- **OW Cac vs. Dax and Italy vs. Spain:** Dax is overly exposed to trade, manufacturing and EM. Cac has a more diversified sectoral and regional exposure. Italian political risk has reduced and fiscal discipline will likely improve with the new government. Valuations are cheap and Italian equities still have relative upside to close the gap with tighter BTP spreads.
- **OW UK vs. Eurozone, FX-hedged**: Weak GBP is a silver lining for UK equities. While a lot appears to be in the price, political uncertainty may not go away anytime soon. This should provide a cap to GBP, help the relative performance of UK vs. EU equities and support exporters (FTSE100) vs. domestic plays (FTSE250). The UK equity market is also biased to defensive value sectors, which we like.

Favour Value over expensive Cyclical and Growth plays

- **We hold a defensive sector allocation:** Cyclicals bounced recently but the gap with PMIs and bond yields has not closed, valuations are not depressed and earnings risks are tilted to the downside. We are UW Tech, Chemicals and Cap Goods, and cut Luxury Goods and Mining from OW to MW in August. We upgraded Healthcare to OW in May and added to Defensives value by raising Utilities to OW in early August. We are OW Energy, which we see as a good and cheap compromise between cyclicality and defensiveness/yield, and UW Staples, which we see as a crowded bond proxy.
- **MW Financials.** We cut Banks from OW to MW at the end of Q1. The sector rebounded last month along with bond yields but is still under-owned and valuations are depressed. Structural headwinds are plenty, but the recent stabilisation bond yields is a positive for the sector. We continue to favour Insurance (OW) as its profitability and capital position is stronger than for Banks.
  - **OW** Healthcare, Utilities, Real Estate, Insurance, Energy, Construction Materials.
  - **MW** Autos, Telecoms, Banks, Mining, Luxury Goods.
  - **UW** Industrials, Chemicals, Tech, Staples.
- **Stabilisation in bond yields helps Value**. Amid elevated uncertainty, we find the extreme polarisation in market internals unhealthy. We have been warning against crowded Quality/Growth trades for some time now and find Value offering a more balanced risk-reward, regardless of the near-term market conditions.
- **Remain cautious on EM exposure (BCEUEREM):** Strong dollar, trade uncertainty, CNY weakness and Chinese activity slowdown remain headwinds for EM equities. EM $ fixed income have seen healthy inflows recently as the dovish Fed reactivated the carry trades; however, EM equities keep seeing outflows. EM relative valuations and earnings dynamics vs. DM are unexciting, in our view.
- **Themes**: Corporate leverage: BCEUELDR/BCEUEHDR; Wage inflation: BCEUEWIN; Trade war: BCEUTRAD; EU fiscal spending: BCEUEUDR; Oil price volatility: BCEUVEHCO/BCEUELCO; UK exporters/domestics: BCEUUKEX/BCEUUKDM; Value/Growth (BCEUVALO/BCEUGROW); cash return (BCEUERIC); Cyclicals/Defensives (BCEUECYC/BCEUEDEF).

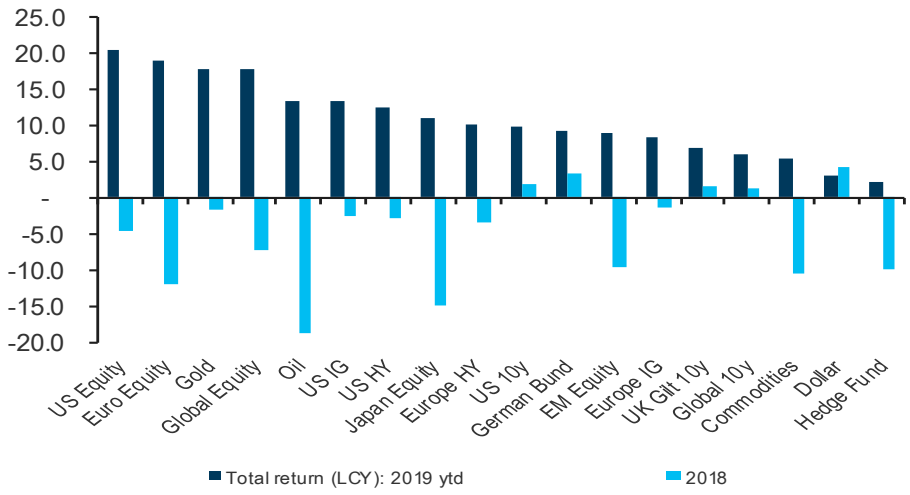
(1), (2), (3), (4): please refer to slide 184 for hyperlinks to previously published research reports.

Unsettling rally

Stocks are back to the top of the ytd range

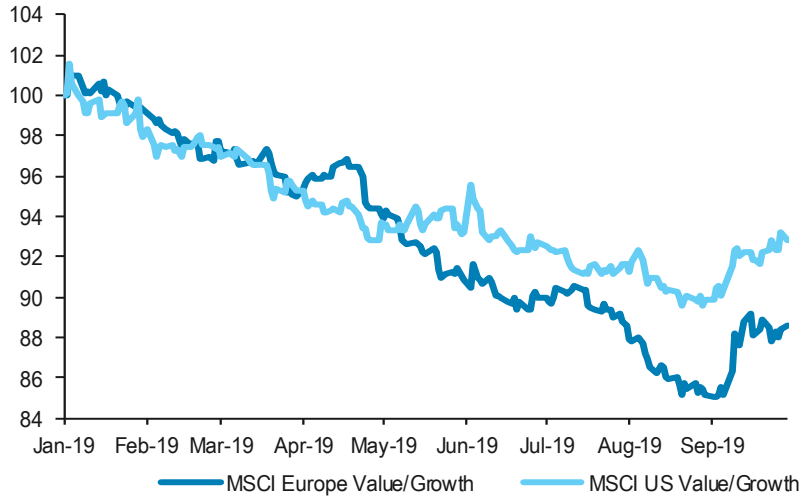
- Equities fell sharply in August, led by Cyclicals, but rebounded strongly in September, with Value and Cyclicals leading on the way up.
- Equities are now back to the top of the ytd range and are outperforming most of the other asset classes.

All the asset classes are up ytd, equities the most



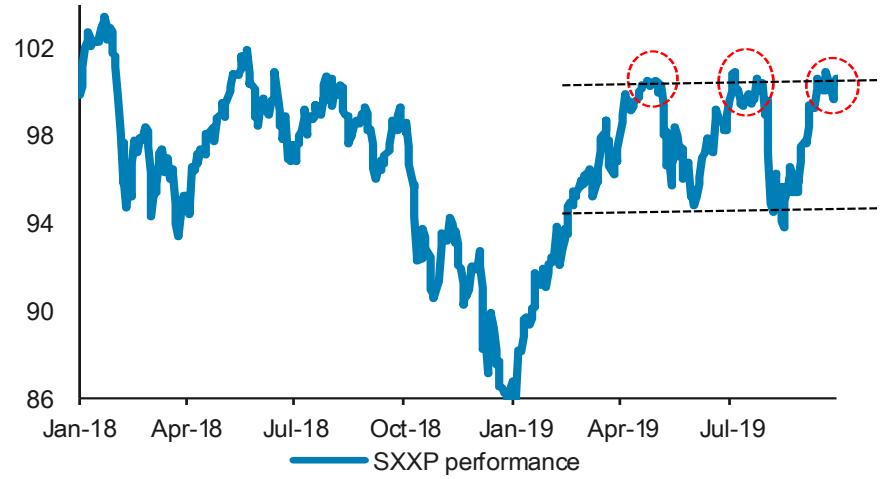
Source: Datastream, Bloomberg

Value rotation is at play



Source: Bloomberg

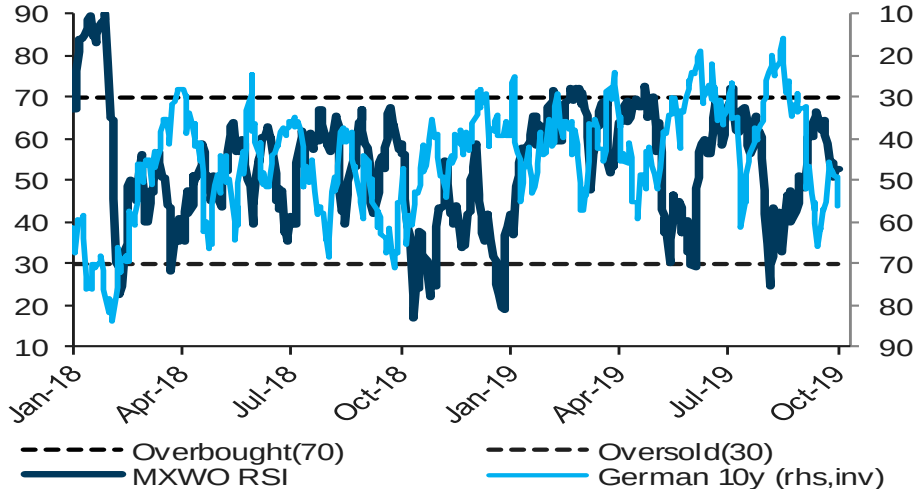
Triple top? SXXP is back to the top of the ytd range, again



Source: Bloomberg

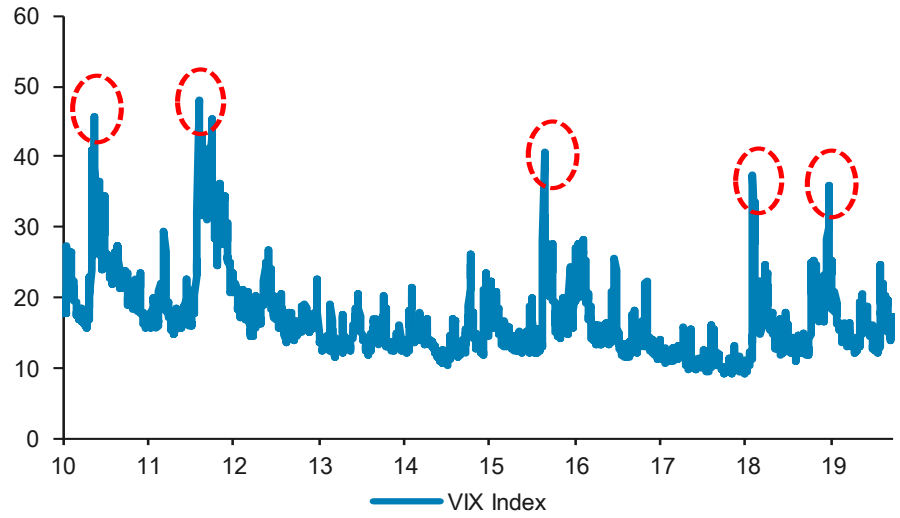
Market technicals have normalised following the recent bounce

Equities RSI has recovered from oversold levels

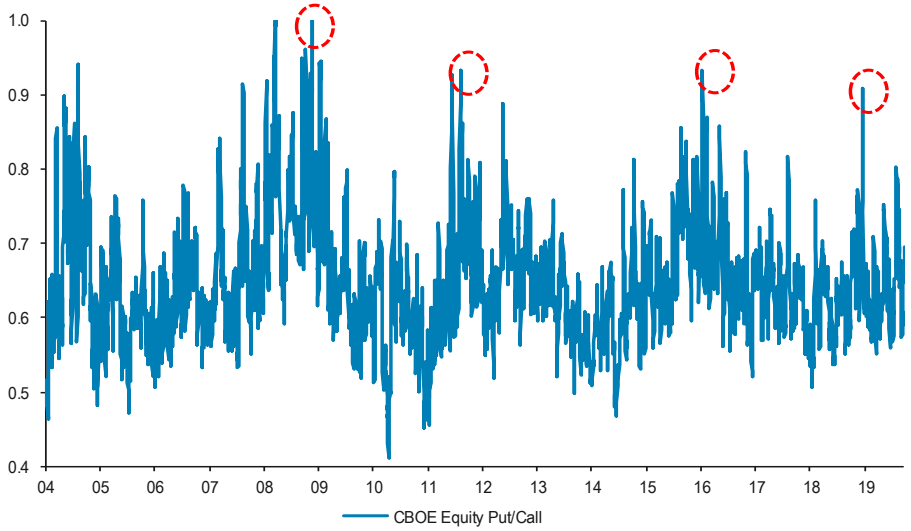


Source: Bloomberg

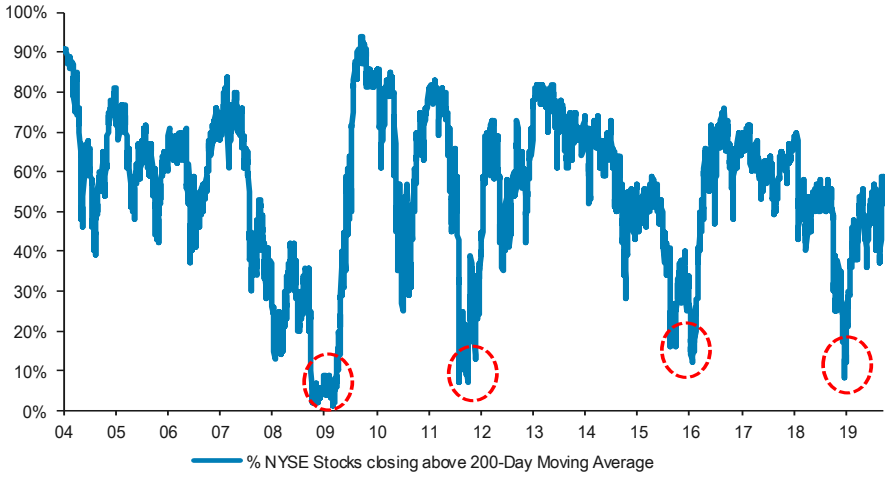
VIX has cooled down from the recent highs



SPX Put/Call ratio is back to the lows



% NYSE stocks above 200-Day moving average



Source for all charts: Bloomberg, Barclays Research

Vol has come down, but investors hold protection and skew is elevated

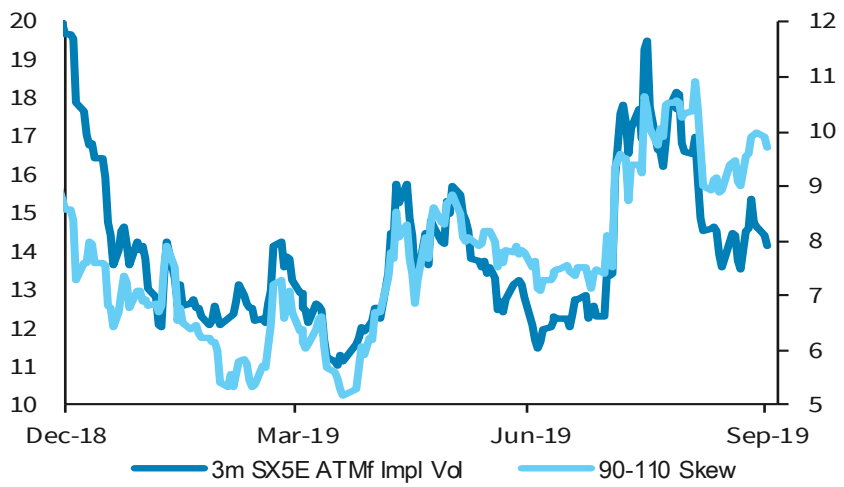
- Despite equity markets being near highs, equity volatility and measures of stress remain elevated.
- Investors still look to be cautious given elevated Put/Call ratio, Skew & Term Structure all still showing stress.
- Specific Brexit (GBP) and trade war (CNY) related assets also showing higher level of hedging.
- Gold volatility and most recently Oil volatility have jumped, but downside skew is low, showing investors positioned for more upside in those assets.
- However, safe haven currencies JPY and CHF vol/stress measures have reduced potentially showing less demand for macro tail hedges.

Implied Vol stress measures have fallen as trade war and Brexit stress receded

	1m Vol	1m Skew	3m Vol	3m Skew	3-12m Term
S&P 500	83%	84%	86%	95%	79%
Eurostoxx 50	60%	90%	62%	97%	78%
FTSE 100	68%	88%	76%	93%	85%
Nikkei 225	47%	37%	46%	71%	59%
MSCI EM	65%	88%	54%	67%	51%
Hang Seng	74%	80%	74%	94%	73%
EURUSD	22%	51%	13%	42%	44%
GBPUSD	90%	61%	91%	82%	98%
USDJPY	26%	18%	13%	9%	64%
USDCHF	24%	21%	13%	20%	64%
USDCNY	70%	68%	65%	60%	91%
Gold	82%	30%	79%	32%	45%
Oil	86%	18%	85%	9%	87%

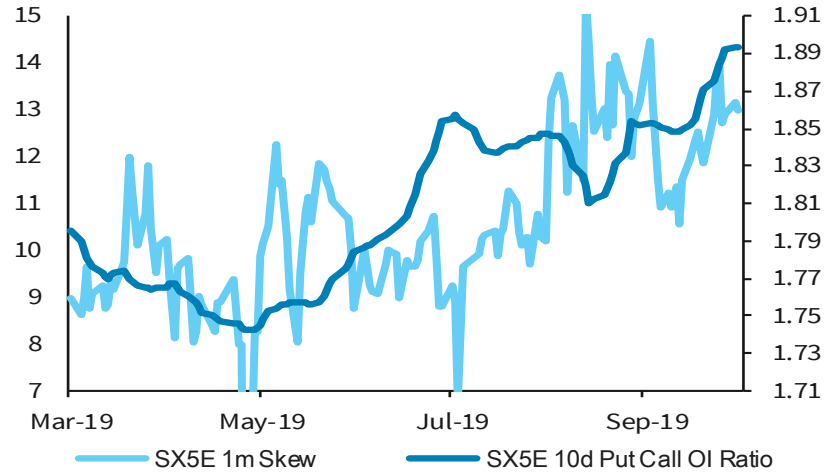
Source: Bloomberg

Eurostoxx 50 3m Impl. Vol and 90-110 Skew elevated



Source: Bloomberg, Barclays Live

Put/Call ratio jumped on trade war in May, never really dropped, and is making new highs now

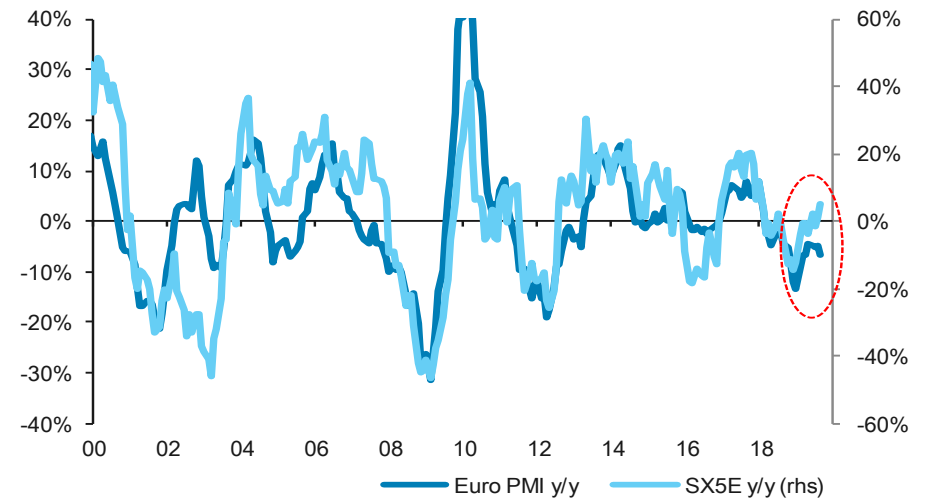


Source: Bloomberg, Barclays Live

Fundamentals are yet to confirm the latest risk-on

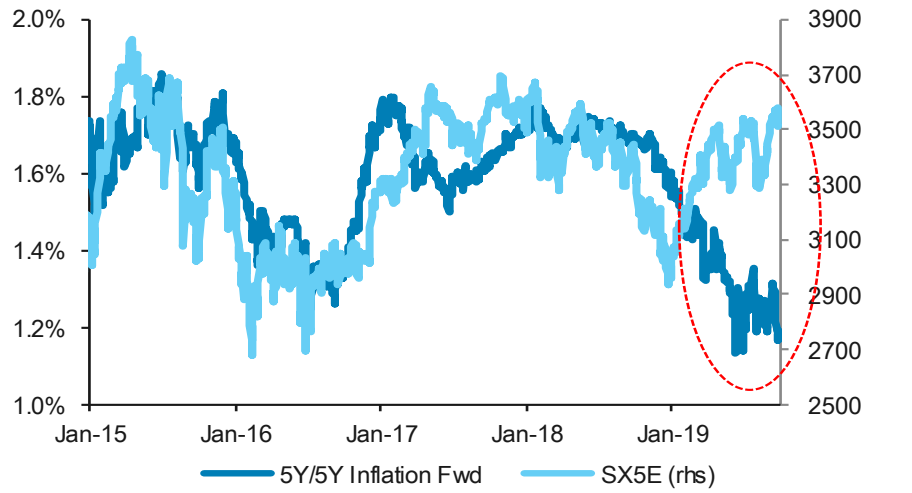
- Equities are back to the highs, but fundamentals are yet to improve.
- PMIs fell further in September, EPS revisions are negative and inflation expectations keep rolling over.

SX5E has overshot PMI recently



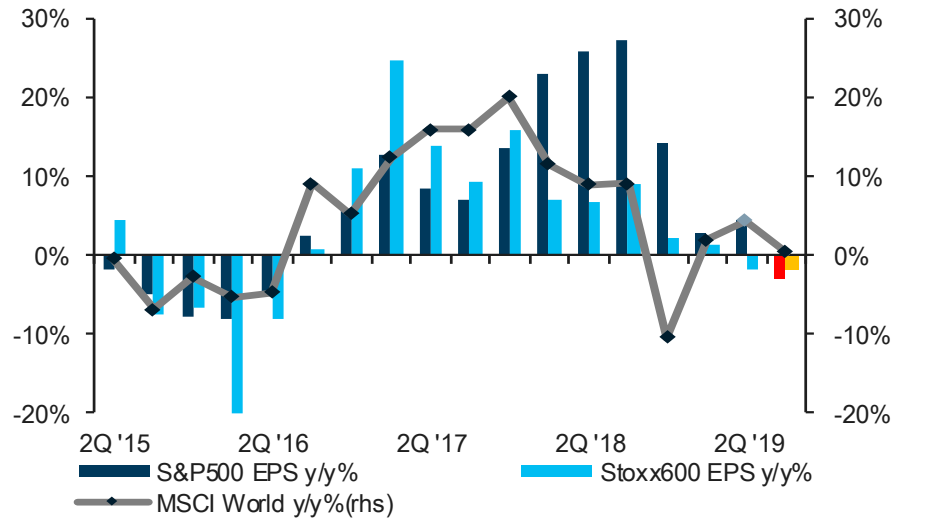
Source: Bloomberg

Equities have rallied despite falling inflation forwards



Source: Datastream

Q3 earnings are unlikely to be great

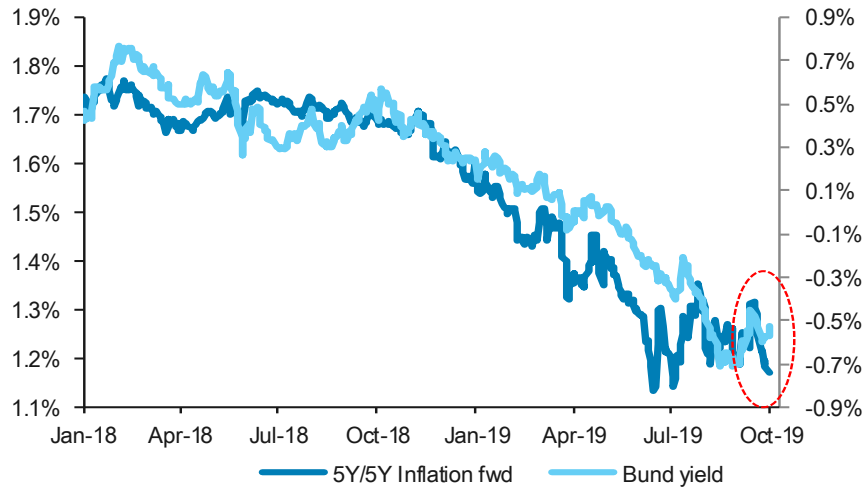


Source: Datastream, IBES

Macro indicators send conflicting signals

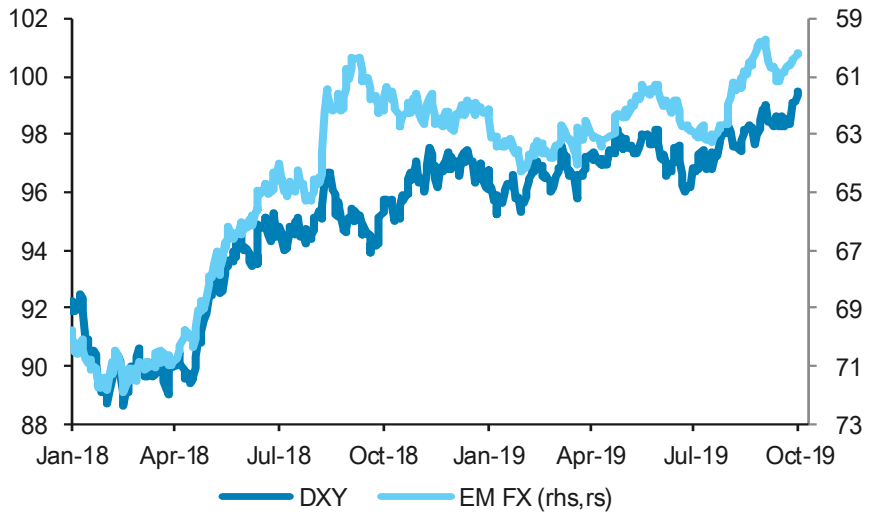
- Bond yields have rebounded recently, but with falling inflation expectations -> the move was driven by real rates, which is not a positive for growth.
- Dollar rebounded further in September, while EM FX weakened -> a negative for EM and commodities.
- The recent reversal in JPY and gold send a more positive message, though.

Bond yields are up but inflation forwards are down



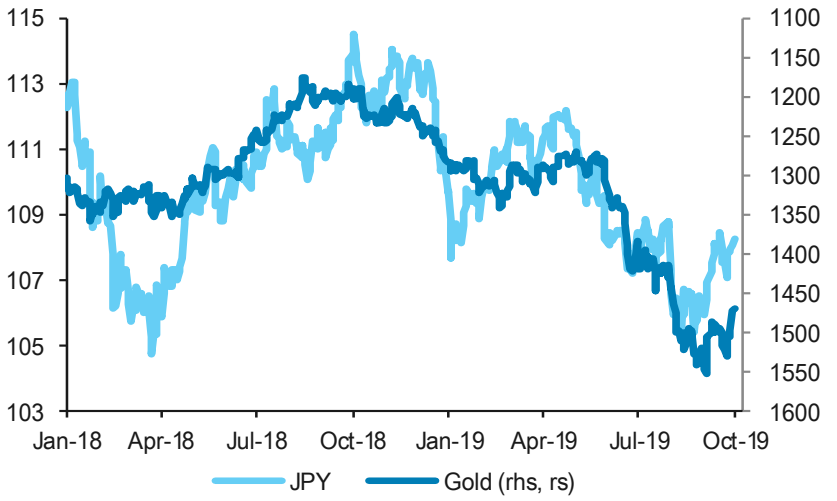
Source: Bloomberg

Strong dollar and weak EM FX call for caution…



Source: Bloomberg

…but falling JPY and Gold send positive signals

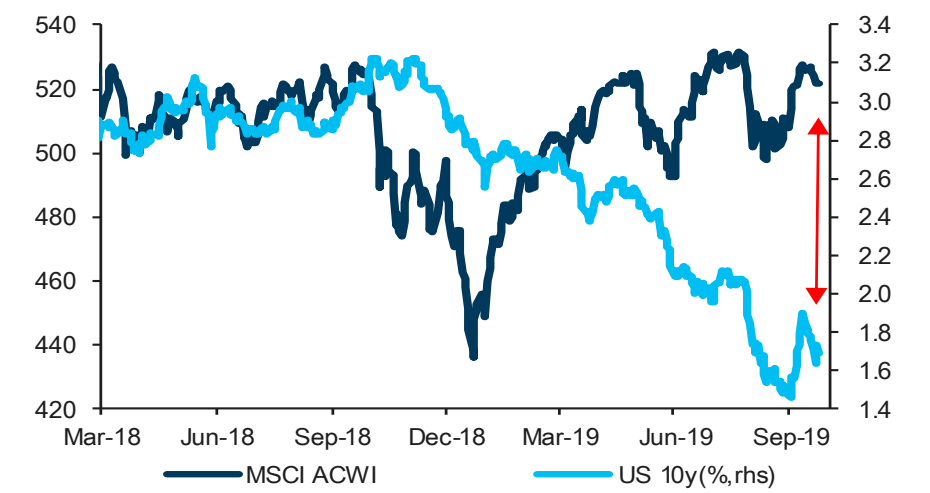


Source: Bloomberg

The stabilisation in bond yields is welcome, but upside looks limited

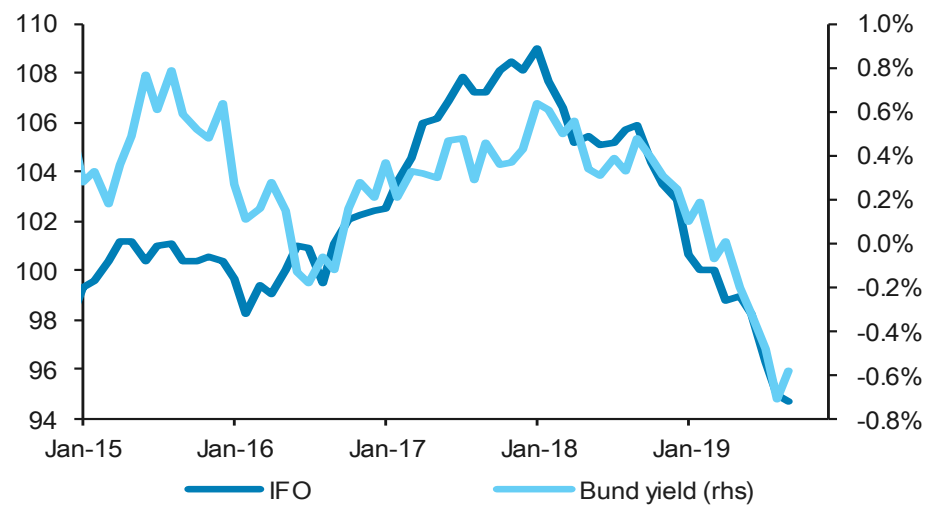
- Courtesy of the dovish central banks, equities rallied along with falling bond yields ytd. While the resilient equity market is at odds with the weakening activity momentum, bond yields have not decoupled from leading indicators.
- Most recently bond yields have stabilised even though activity and inflation remain weak. We believe that bond yields might not move much lower from here as a lot of central banks easing appears to be in the price already while talks of fiscal stimulus are rising.
- However, significant bond yields upside is unlikely if activity momentum does not pick up.

Equities and bond yields have diverged ytd



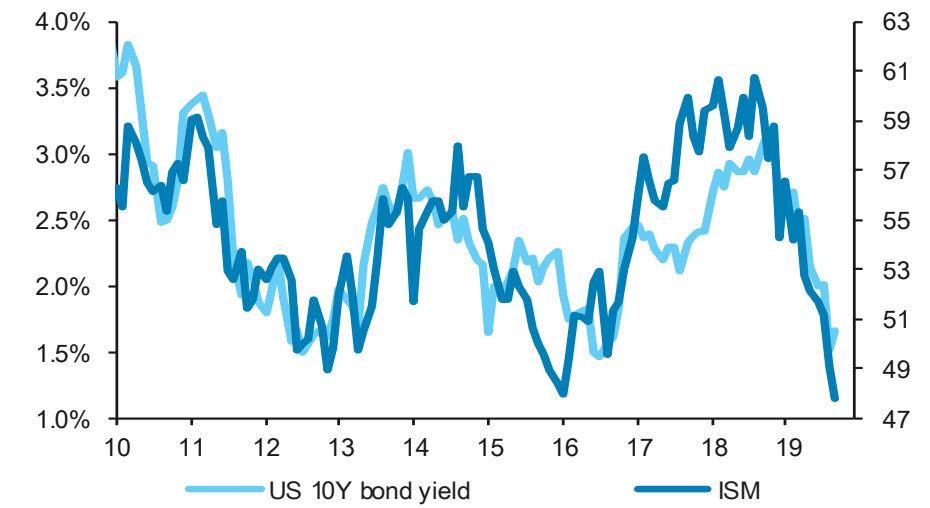
Source: Datastream

German yields have fallen with PMI/IFO



Source: Datastream

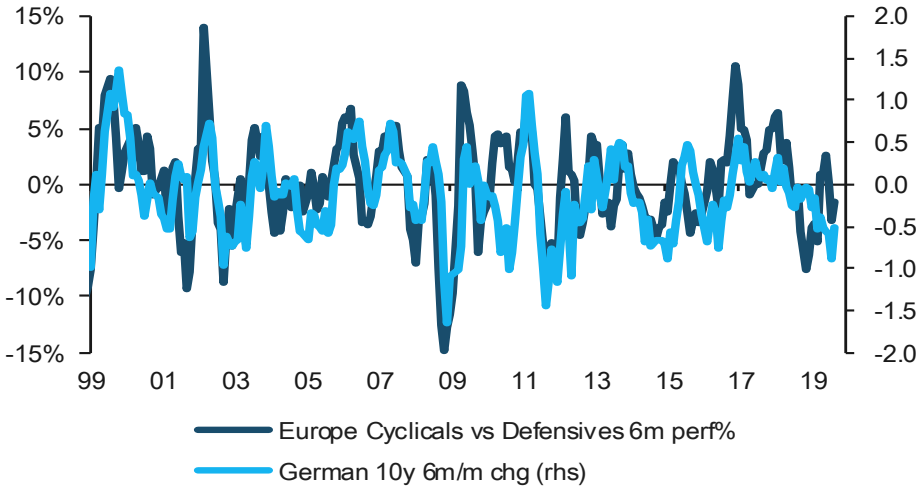
US bond yields have also followed ISM lower



Source: Datastream

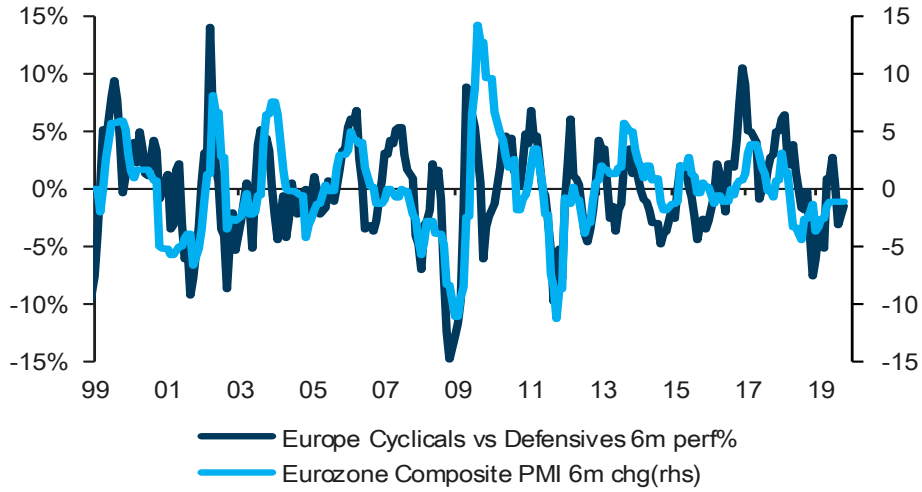
Market leadership follows activity and bond yields

Cyclicals typically move with bond yields…



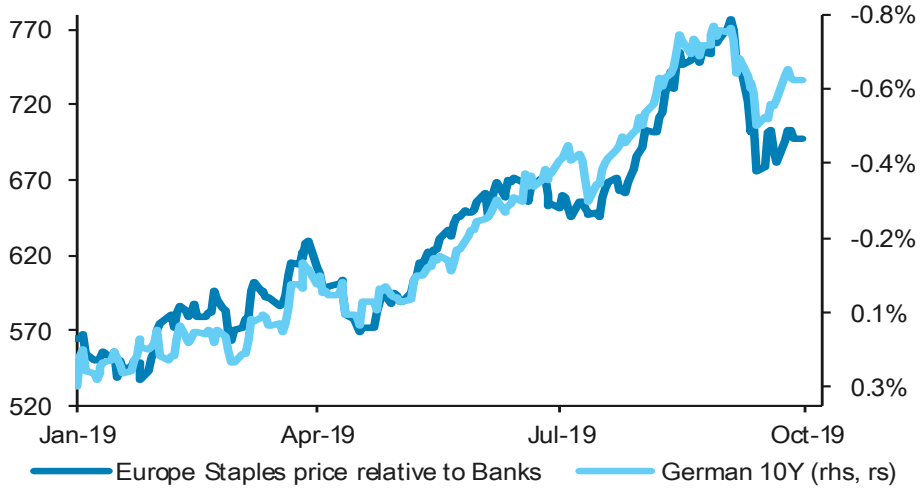
Source: Datastream

…and with PMIs



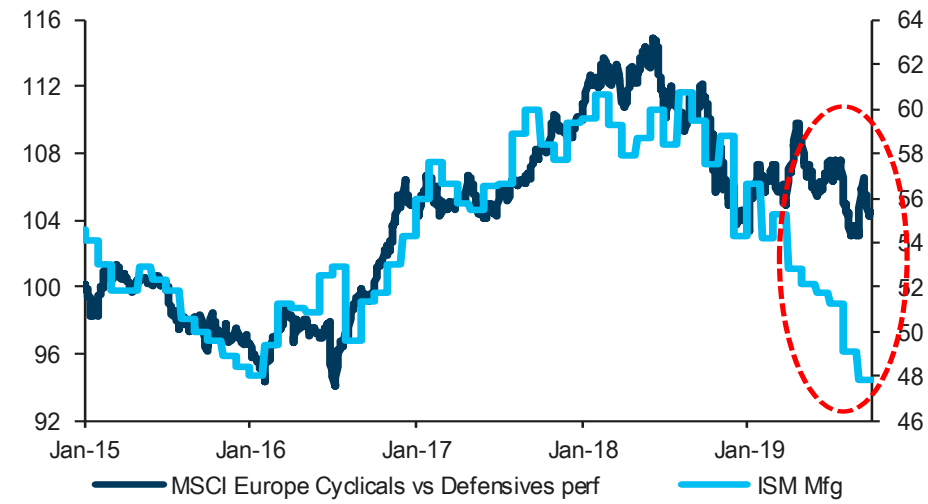
Source: Datastream

Staples (Growth)/Banks (Value) trade is all about bond yields direction



Source: Datastream

Mind the gap between Cyclicals/Defensives and ISM

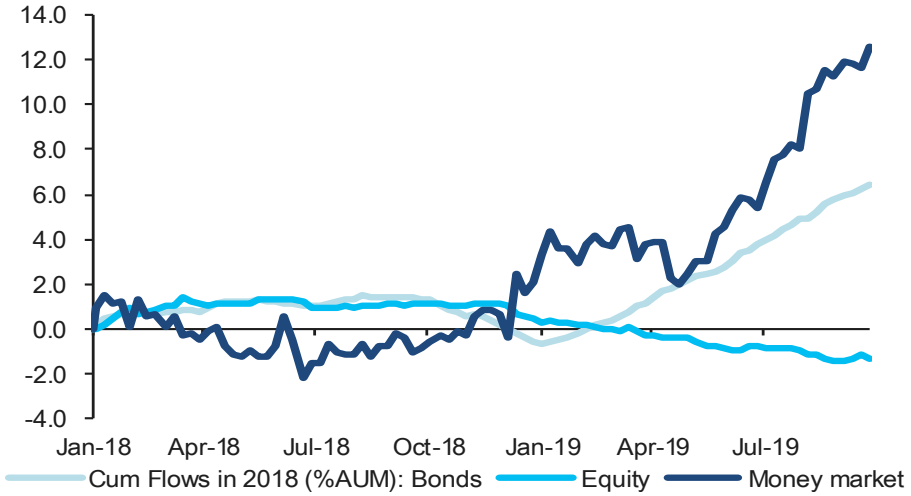


Source: Datastream

Cautious positioning suggests many risks are discounted
Investors have de-risked all year

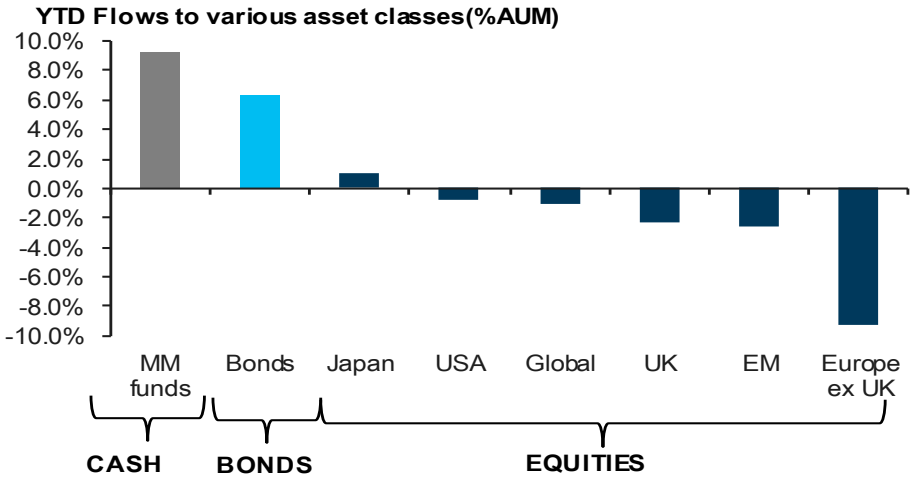
- Contrary to this time last year, complacency is not widespread anymore. Investors materially cut equity exposure in Q4'18 and continued to de-risk ytd, even as equities rallied.
- The money was mainly reallocated to bonds and cash, as asset allocation turned decidedly cautious.

Bonds flows keep growing while equity flows keep falling



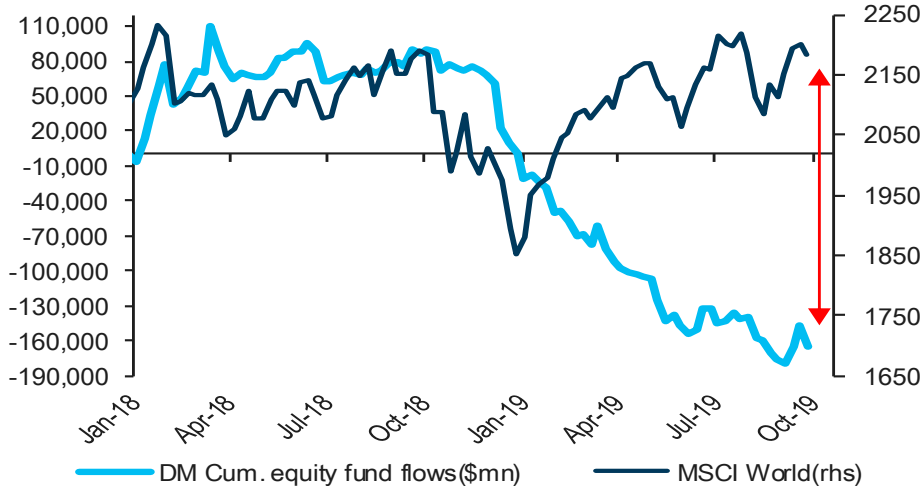
Source: EPFR, Barclays Research

The flight to safety keeps going



Source: EPFR, Barclays Research

Mind the gap – Equity flows and performance have decoupled ytd

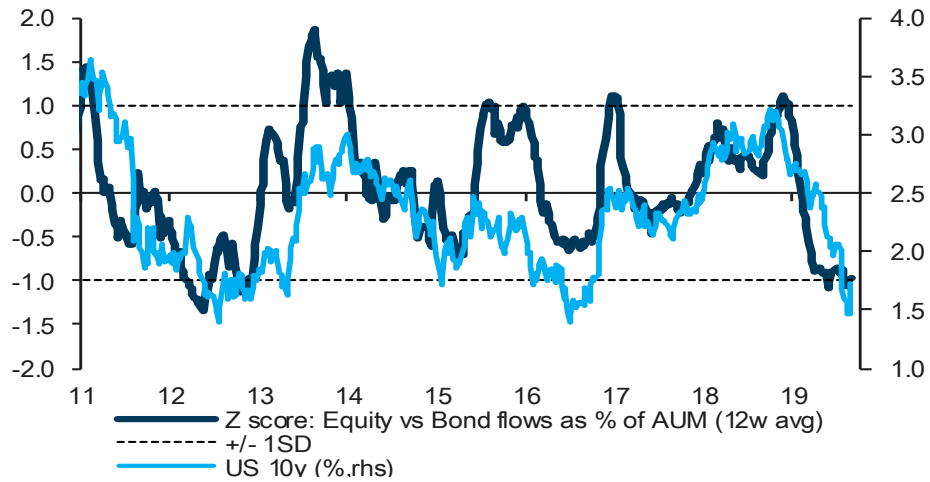


Source: EPFR, Barclays Research

Bond inflows look extreme vs. equities – a good contrarian indicator?

- Past instances of depressed equity/bond flows similar to the one observed at present were typically good contrarian indicators.
- Previous instances ox extreme bonds/equities flows divergence were mostly followed by better equity returns than bonds.

Bond inflows are extreme versus equities

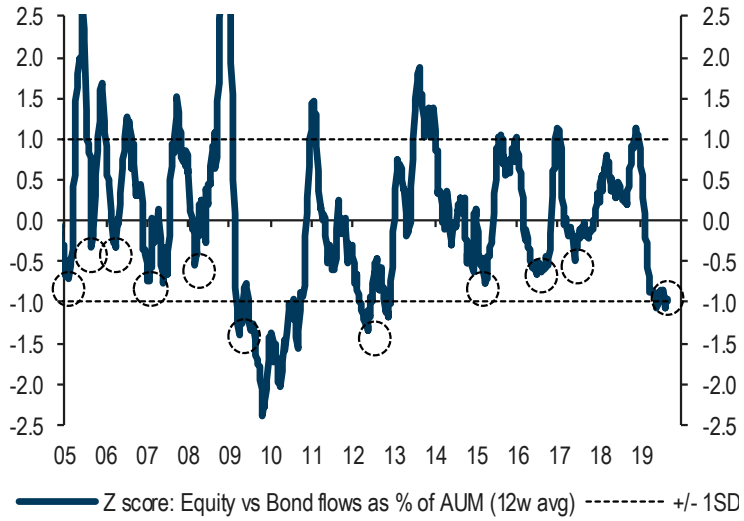


Source: EPFR, Bloomberg

During past episodes, Equities have outperformed versus bonds whenever flows bottomed out

Equity vs Bond flows Bottom date	Equity vs Bond flows Std dev	MSCI AC World (Total return % chg)			Global 10y (Total return % chg)		
		+1m	+3m	+6m	+1m	+3m	+6m
Feb-05	-0.7	-2%	1%	3%	-1%	-1%	-5%
Sep-05	-0.3	-4%	9%	12%	-5%	-3%	-2%
Apr-06	-0.3	-1%	-1%	11%	4%	4%	8%
Jan-07	-0.8	-2%	8%	14%	3%	1%	7%
Mar-08	-0.6	6%	-6%	-43%	-1%	-2%	-6%
Apr-09	-1.4	14%	33%	46%	2%	6%	12%
May-12	-1.4	6%	11%	21%	1%	4%	2%
Apr-15	-0.8	4%	1%	-4%	0%	-3%	-1%
Jul-16	-0.7	6%	5%	15%	1%	-4%	-9%
Jun-17	-0.5	2%	6%	12%	0%	1%	4%
Average	**-0.7**	**3.0%**	**6.8%**	**8.6%**	**0.3%**	**0.4%**	**1.1%**
Median	**-0.7**	**2.9%**	**5.5%**	**12.1%**	**0.4%**	**0.0%**	**0.5%**

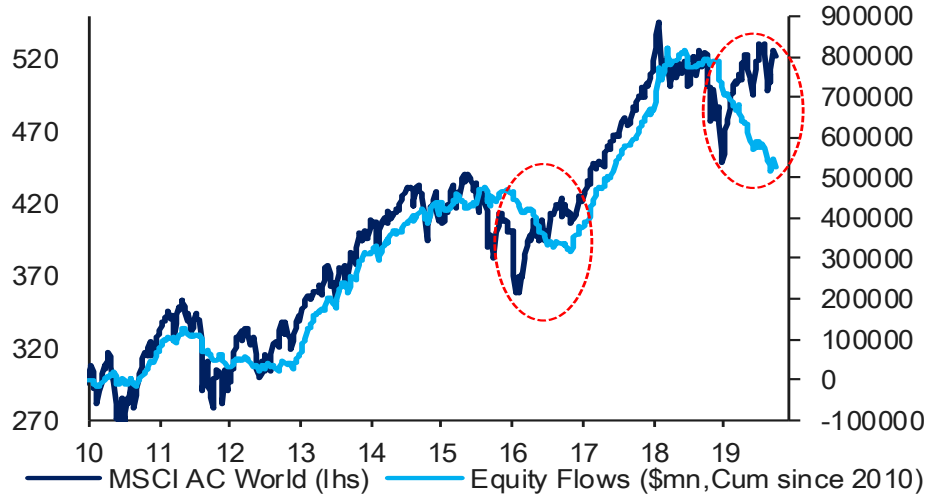
Source: EPFR, Datastream, Bloomberg



Equity flows stabilised in September as activity surprises bounced …

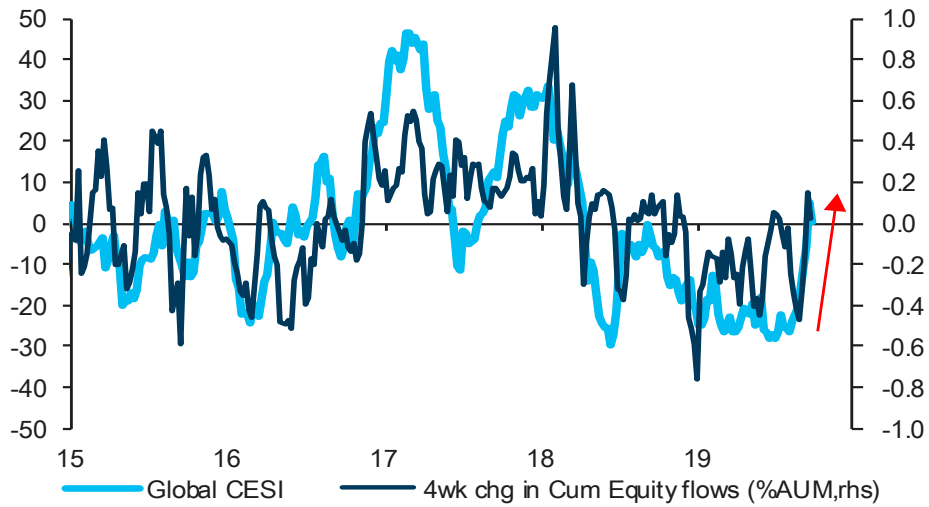
- The divergence between equity performance and equity flows seen ytd is not unusual. Indeed, flows typically lag performance – a similar situation to the current one happened in 2016, when equities troughed in Q1 while flows only rebounded in Q4.
- We note that the latest bounce in equity flows coincided with the rebound in global CESI, which turned positive for the first time in more than a year.
- This supports our view that investors need to see good news on the activity front to add back to equities.

Equities flows lagged during previous instances of markets turnaround



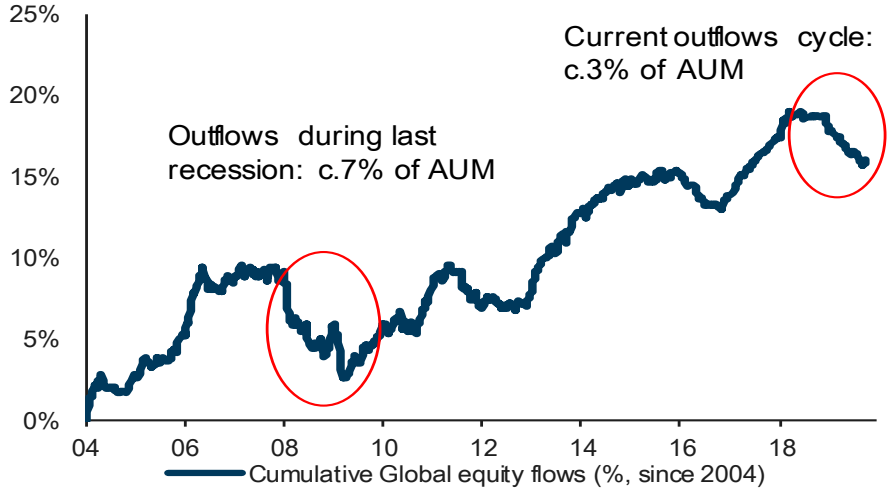
Source: EPFR, Barclays Research

The rebound in equity flows coincided with the pick-up in economic surprises



Source: EPFR, Barclays Research

Global equity outflows amount to 3% of AUM since Dec'18 vs. 7% during the last recession

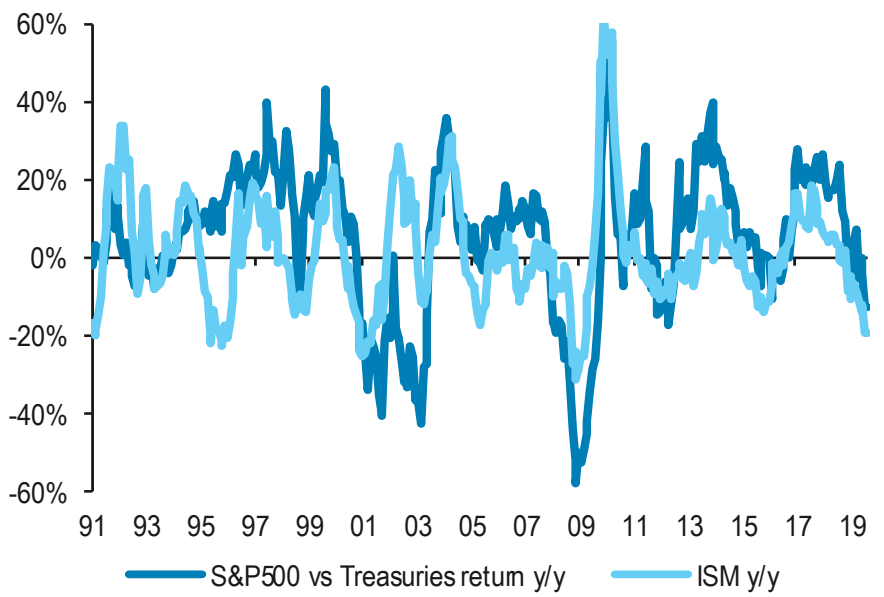


Source: EPFR, Barclays Research

…but more is needed for the bond/equity trade to reverse

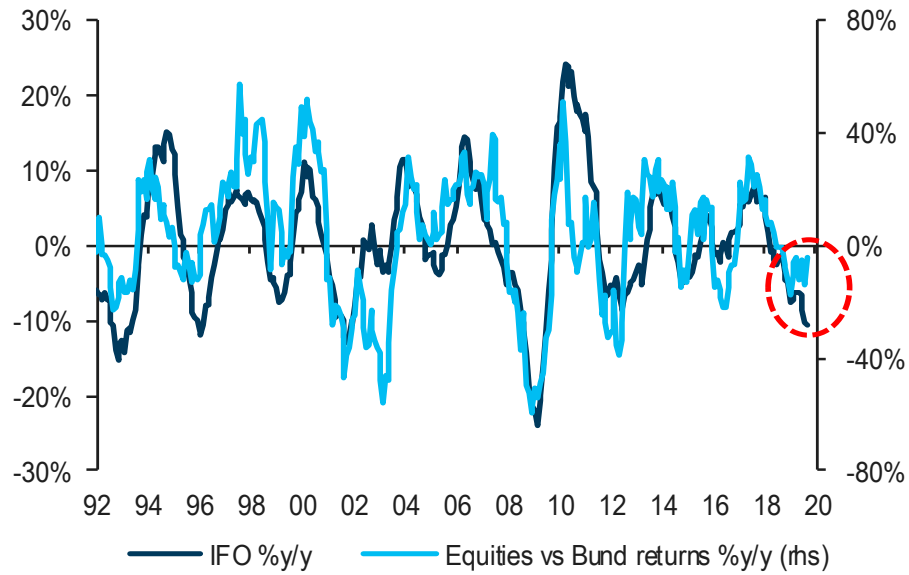
- While equities are up strongly ytd, they are underperforming bonds on a 12-month basis, consistent with the rollover in leading indicators.
- Manufacturing PMIs are tilted to the downside across the board, which calls for limited market upside for now.

Equities/Bonds trade follows activity momentum – in US…



Source: Datastream

…and in Europe

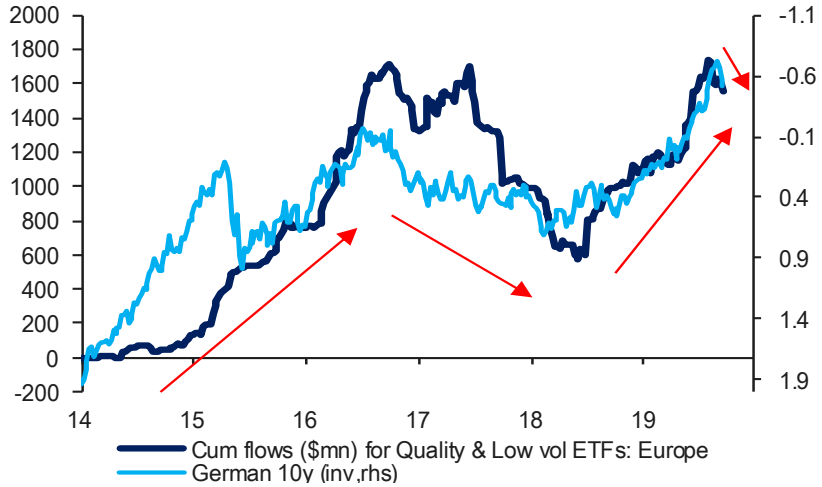


Source: Datastream

Quality and low vol plays are crowded longs…

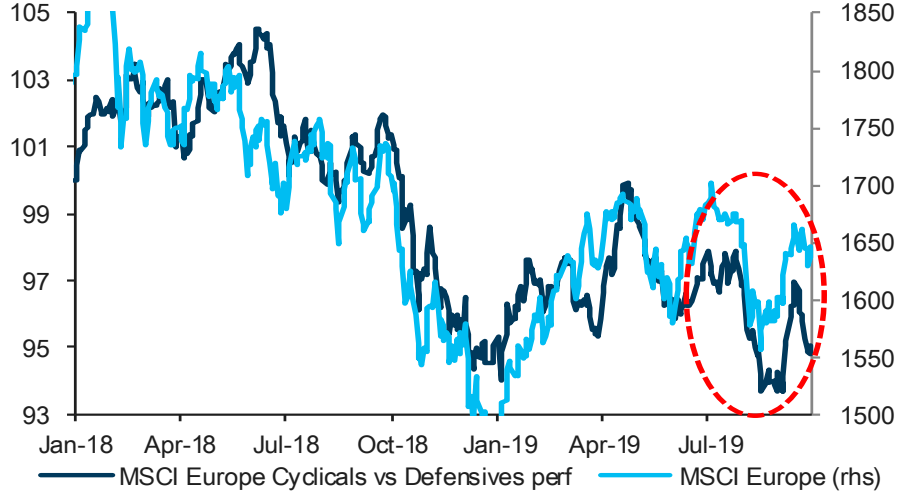
- While equity indices are near the highs, the dispersion between winners and losers within the market is extreme.
- Growth/Quality stocks have performed well this year, while Value stocks have underperformed sharply.
- Most recently, Value and Cyclicals have rebounded relative to Defensive and Growth.

Quality & Low vol ETF inflows have surged ytd



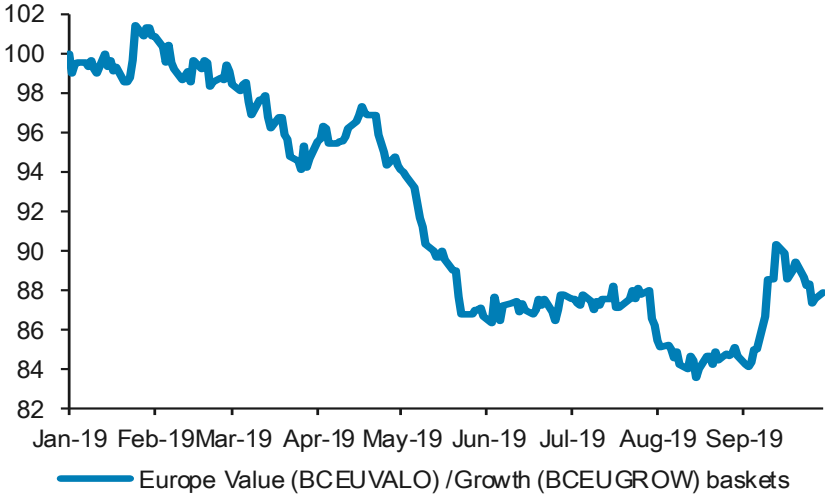
Source: EPFR

Cyclicals/Defensives outperformed in the September after underperforming in August



Source: Datastream

Value has underperformed Growth ytd but rebounded recently

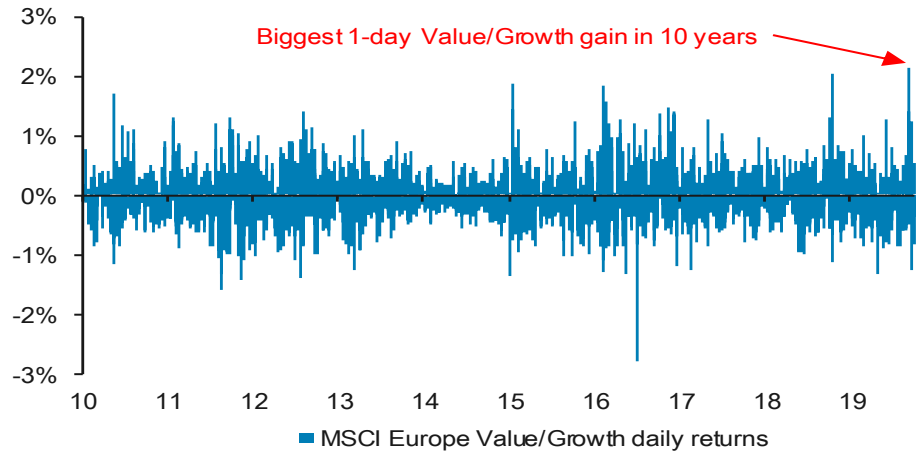


Source: Bloomberg, Barclays Research

…the latest rotation to Value took investors by surprise

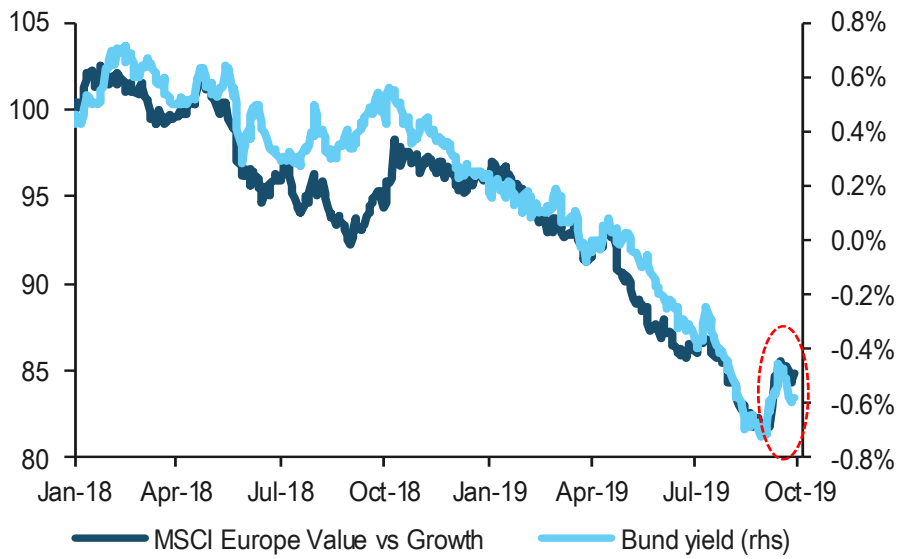
- The latest rebound in equities was accompanied by a sudden style rotation, with Value strongly outperforming Growth.
- We find that only 23% of the European mutual funds that we track outperformed their benchmark in September, down from 59% during the August sell-off.
- This suggests that equity investors' exposure was likely very light at the end of August and that the risk-on move took many by surprise.

MSCI Europe Value outperformed Growth by 2.1% on 10th Sep – the biggest move in more than 10 years



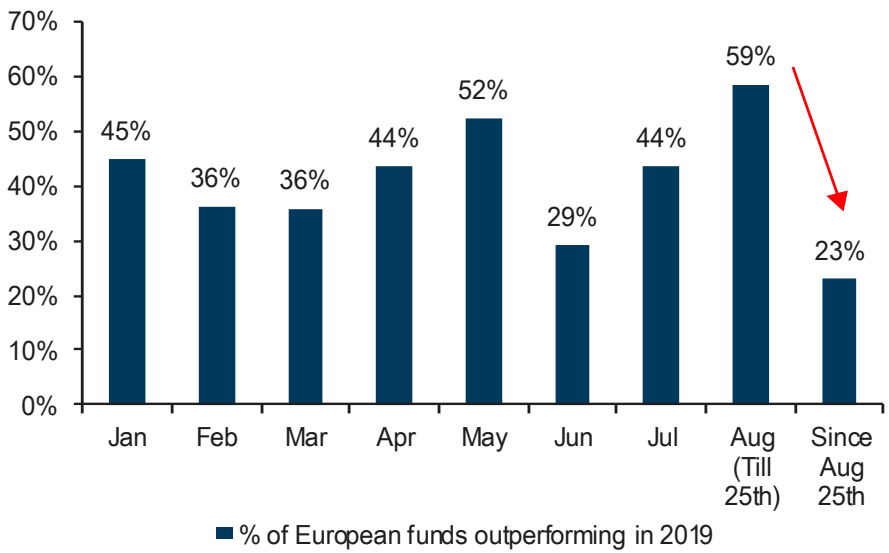
Source: Barclays Research, Datastream

Value underperformed Growth pretty much all year but rebounded most recently



Source: Datastream

The latest rebound has been painful for investors

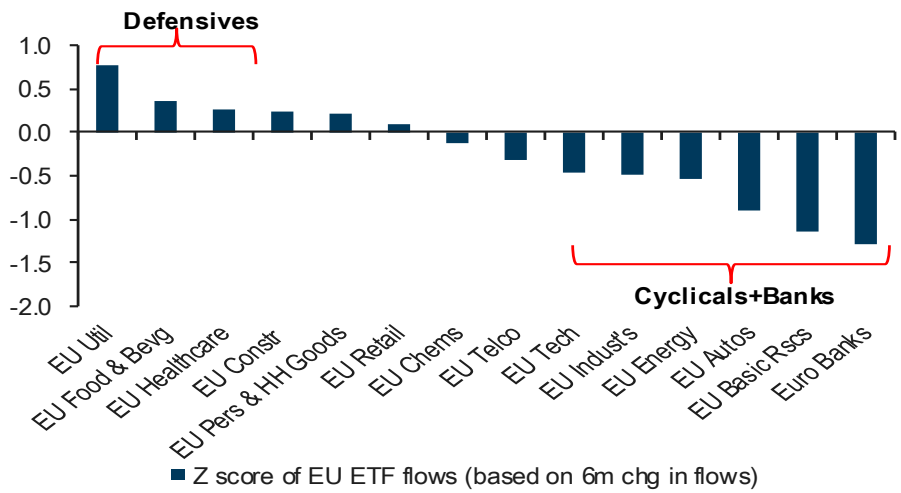


Source: Barclays Research

Safety is expensive - extreme style polarisation is unhealthy

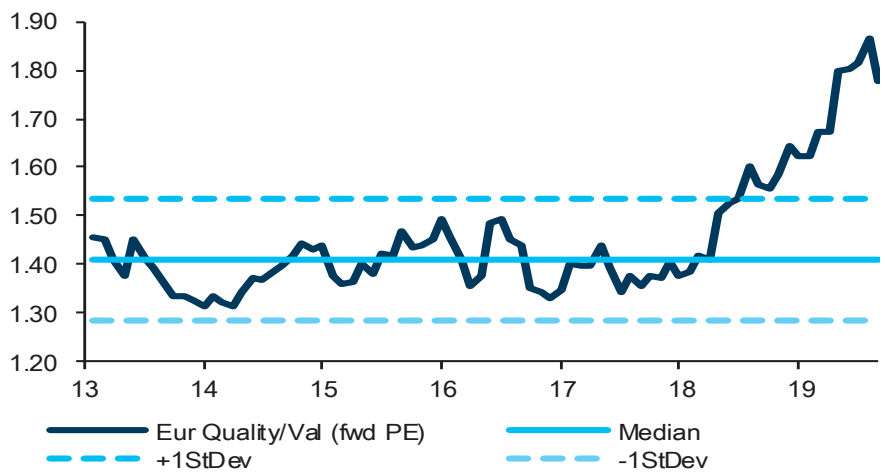
- When we look at sector ETF flows over a long period (6m) we see the rotation into Growth and Cyclicals and away from Value has clearly been large and the reversal of the last few weeks will not have been enough to clean out this bifurcated positioning.
- We believe investors continue to hold a Defensive/Growth/Quality posture in portfolios, with Staples, and the quality parts of Industrials and Cons Disc showing the most crowding.

Utilities ETF flows at extreme high levels while bank flows are at extreme lows



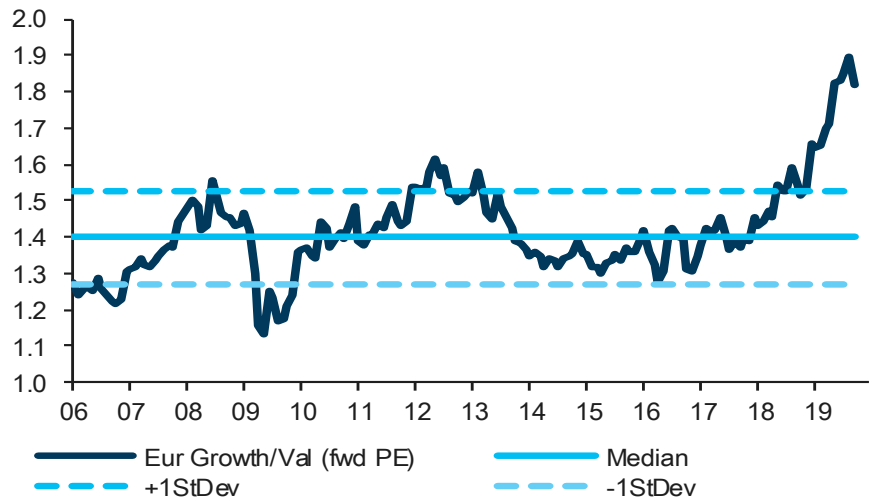
Source: Bloomberg

Quality/Value P/E differential is wide



Source: Datastream, IBES.

The valuation dispersion between Growth and Value is also near extreme

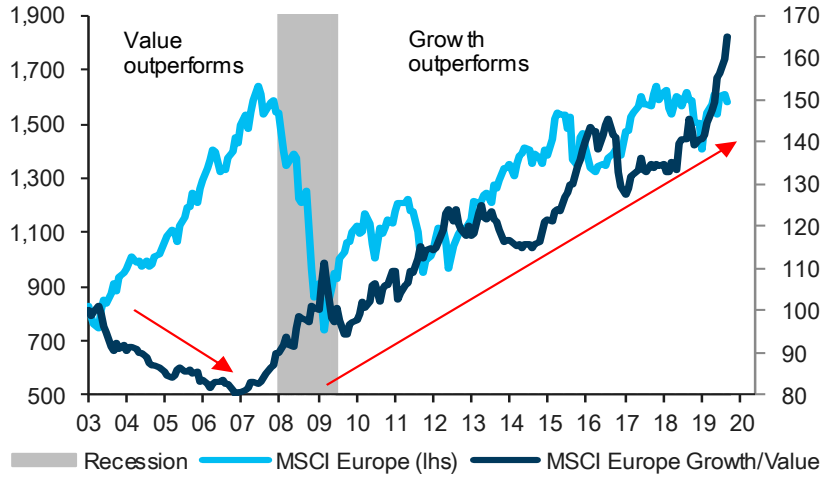


Source: Datastream, IBES.

Growth has led the bull market, Value looks less vulnerable to bad news

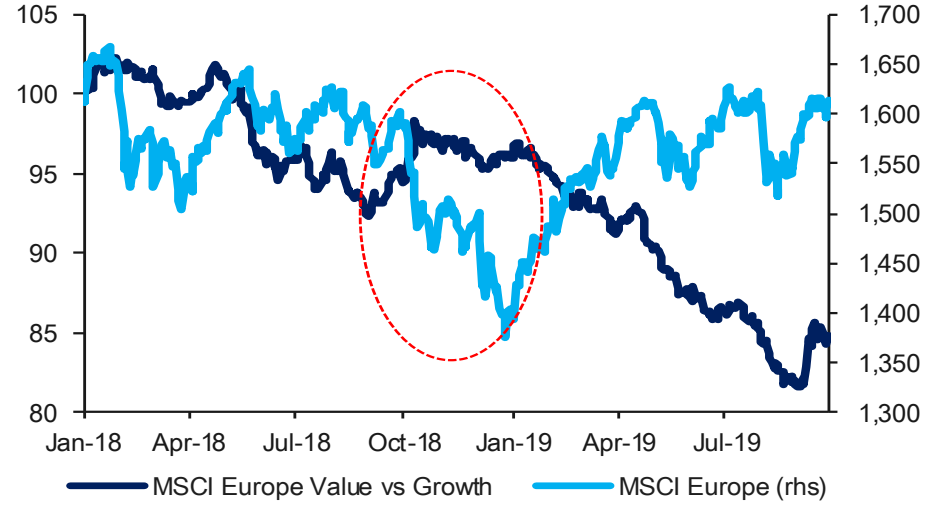
- Value underperformed during the ’08-’09 bear market, but we believe this was because it led the market higher ahead of it.
- This time around, as the current bull-market has been driven by Growth/Quality/Low vol stocks, we believe that they could lead the market lower in the case of a downturn.
- We note that Value outperformed Growth in Q4’18, while the overall market and Cyclicals both fell sharply.

Value outperformed during the ’03-08 upcycle, but Growth has led the current bull market



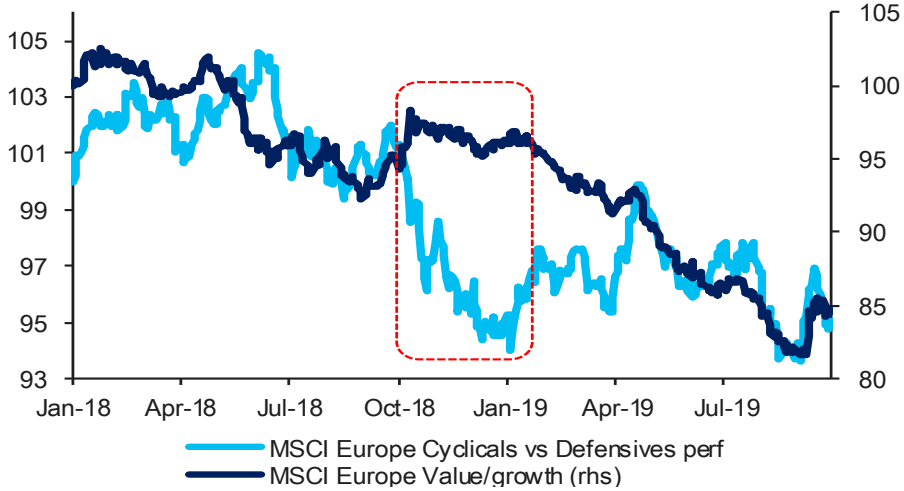
Source: Datastream

Value outperformed Growth while the overall market fell in Q4’18



Source: Datastream

Value/Growth is not the same as Cyclicals/Defensives – Value outperformed in Q4’18, but not Cyclicals

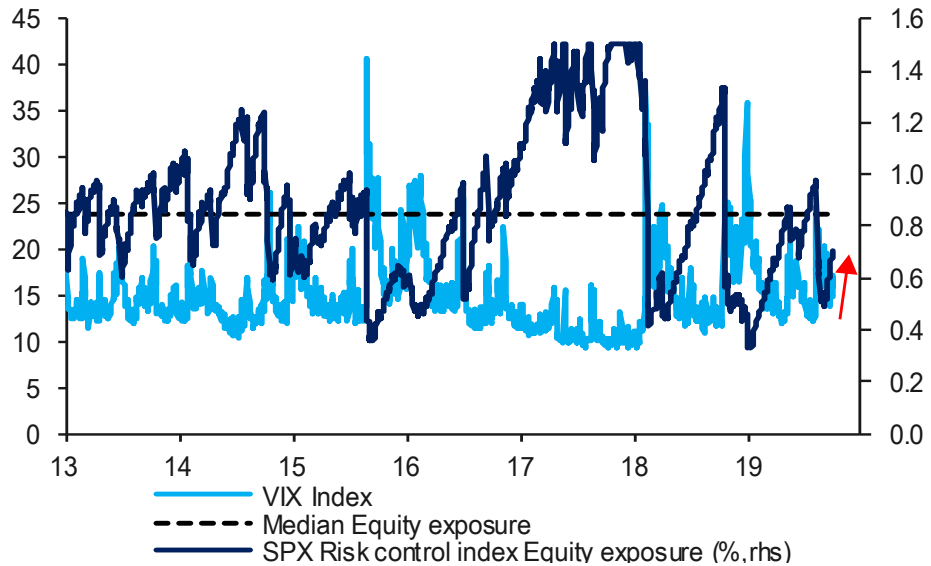


Source: Datastream

HFs are not aggressively long risk

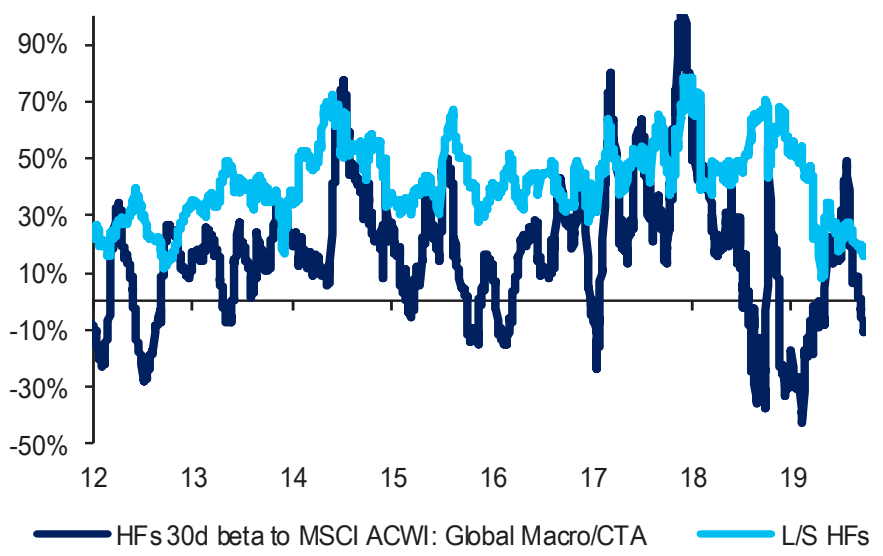
- Long-only investors have shunned equities so far this year, but Macro/CTA and L/S hedge funds also have below-normal equity exposure.
- HFs have reduced their shorts last month recently as the equity market rebounded, but are still cautiously positioned.

Vol targeting funds turned sharply underweight on equities as VIX levels surged but has since bottomed out



Source: Bloomberg

Long/Short and Macro HFs' beta to equities is not elevated

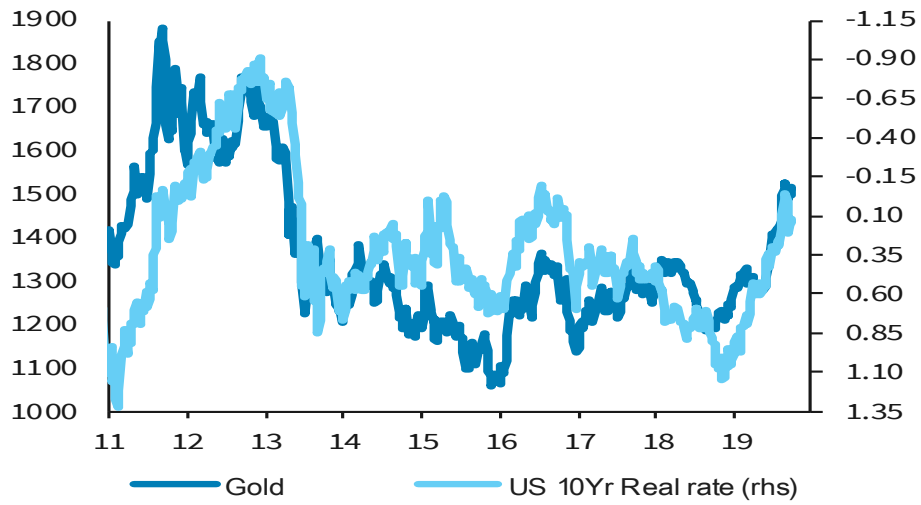


Source: HFRX, Barclays Research, Bloomberg

Investor sentiment is cautious despite resilient equities…

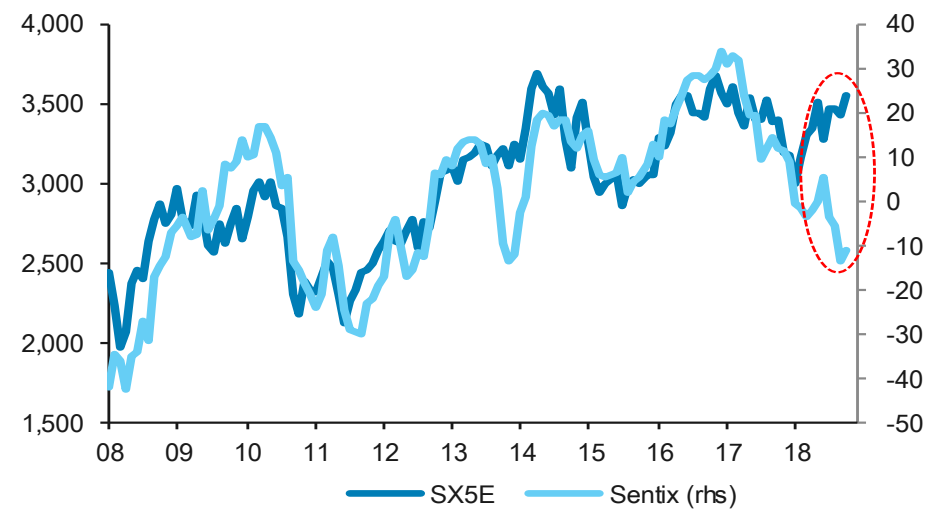
- Investors turned more constructive in Q1 but have become cautious since then, even though equities rebounded. The AAII Bull-Bear is neutral, even though SPX is close to the highs.
- Sentix sentiment survey is negative in Europe, while SX5E rebounded.
- The rally in gold ytd coincided with the fall in real rates.

Real rates down…gold up



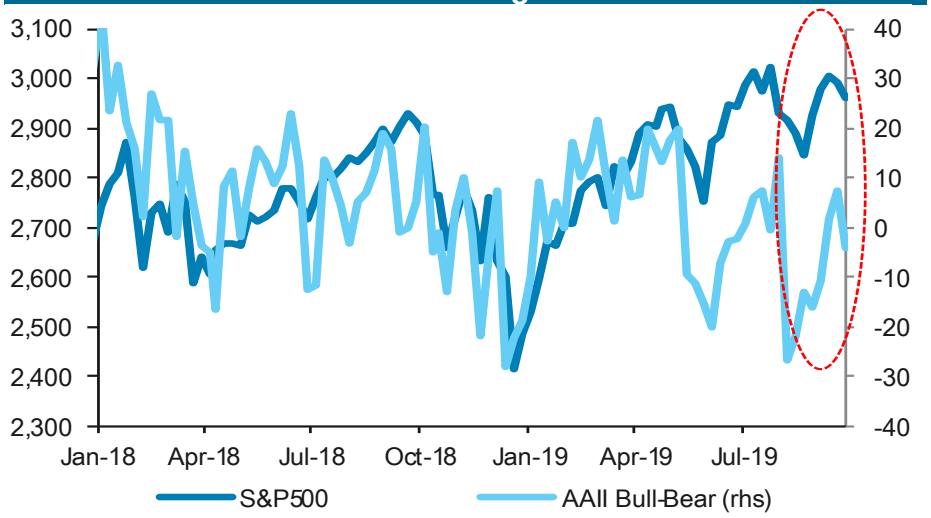
Source: Bloomberg

Sentix sentiment survey is negative despite rising equities



Source: Bloomberg

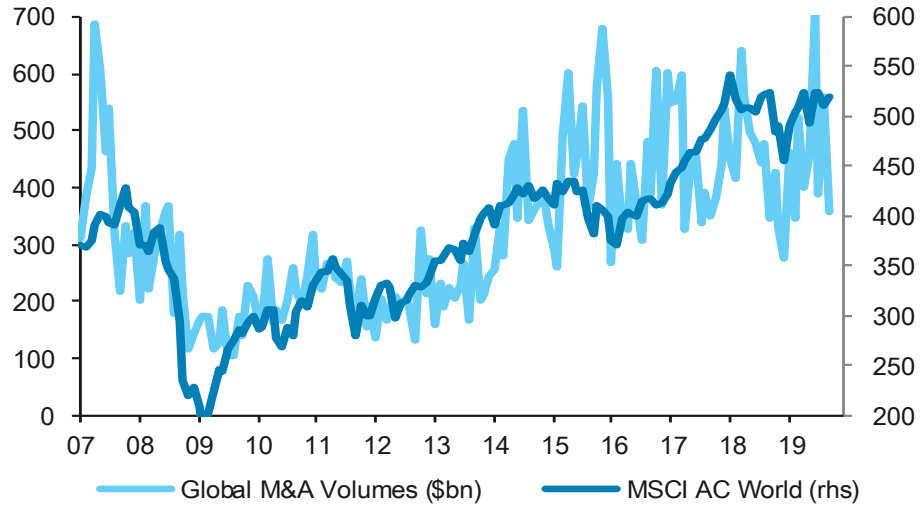
AAII Bull-Bear sentiment is close to zero but SPX is making new highs



Source: Bloomberg

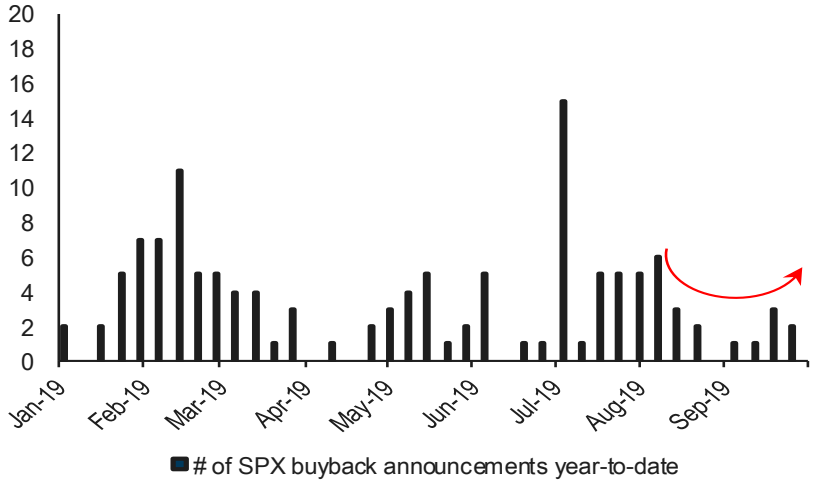
…but not everyone is bearish: corporate activity provides a bid to equities…

M&A volumes strongly rebounded with the market ytd



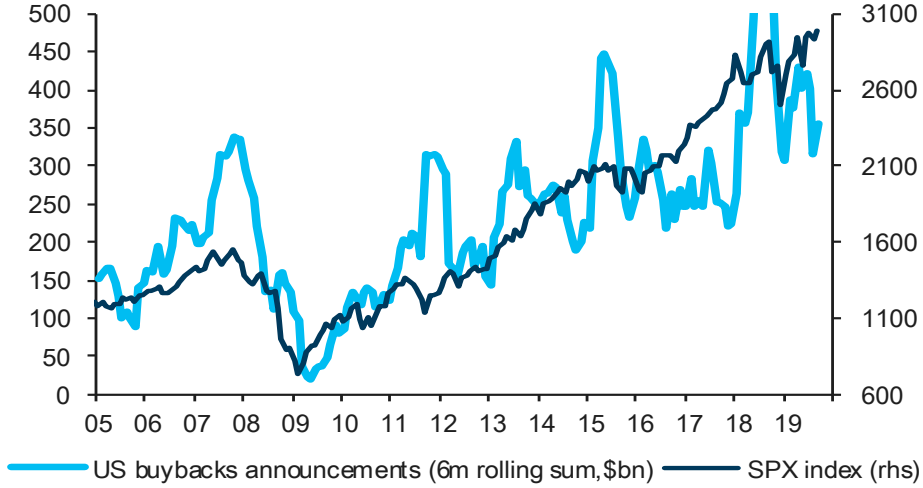
Source: Bloomberg

Buybacks activity likely provided an additional boost to equities in late August / early September



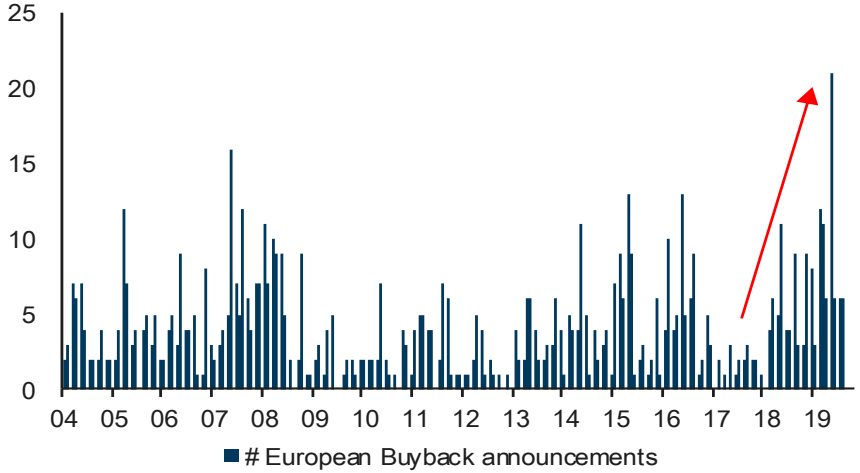
Source: Bloomberg

US buyback announcements have picked up ytd after declining in H2'18



Source: Bloomberg, Barclays Research

European buybacks announcements picking up

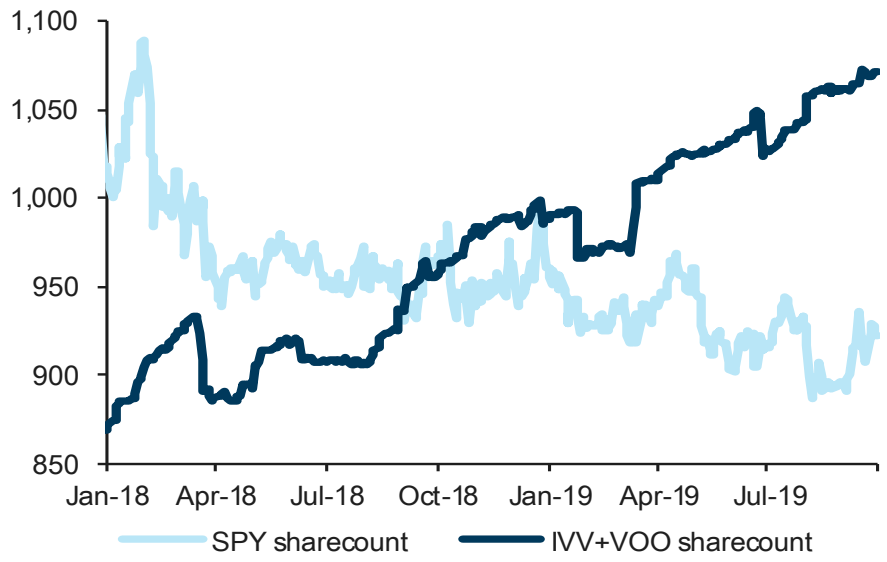


Source: Bloomberg, Barclays Research

…and retail investors have not capitulated

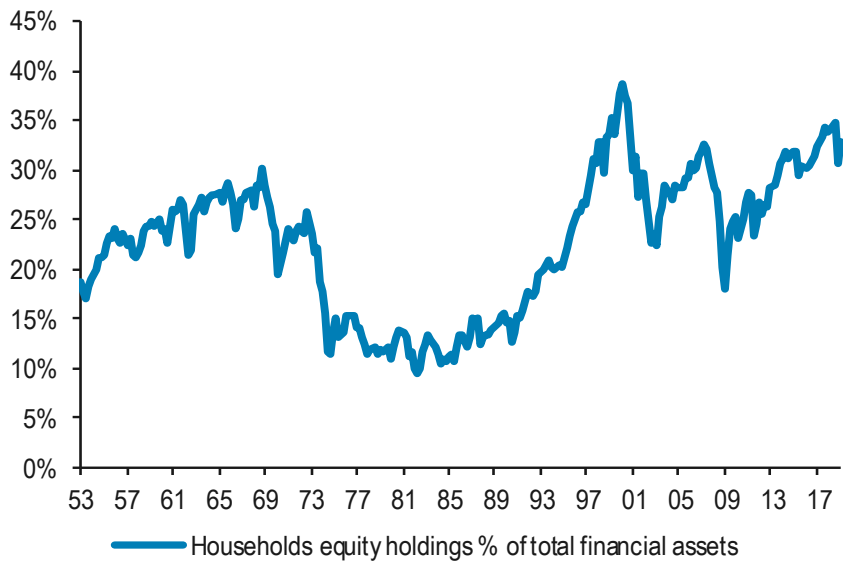
- Retail investors have not reduced equity exposure ytd. Flows into the most popular US equity ETFs, which are good proxy for retail exposure, have remained steady.
- The lack of retail investors selling likely provided some cushion to equities and remains a positive for now.
- However, if US household were to sell equities, it could lead to significant downside to market as their exposure is near the top of the historical range at present.

US equity ETF flows remain steady



Source: Bloomberg

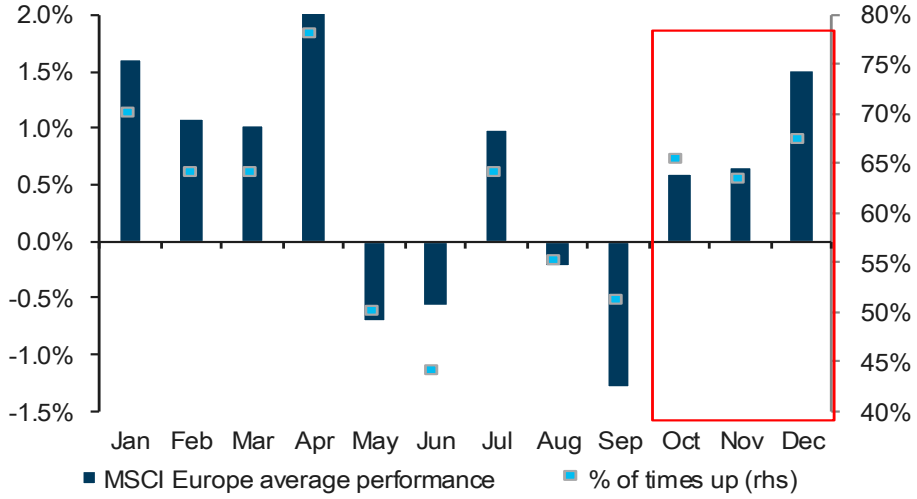
US household equity exposure is near the highs



Source: Fed St Louis

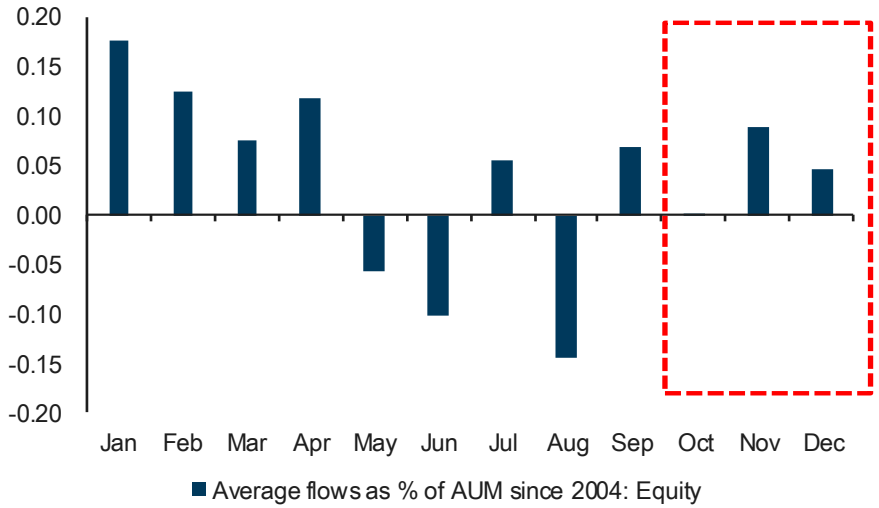
Q4 seasonality is positive

Q4 seasonality is typically positive



Source: Bloomberg, Barclays Research, since 1970

Flows data also suggests that investors exhibit affinity towards equities during Q4

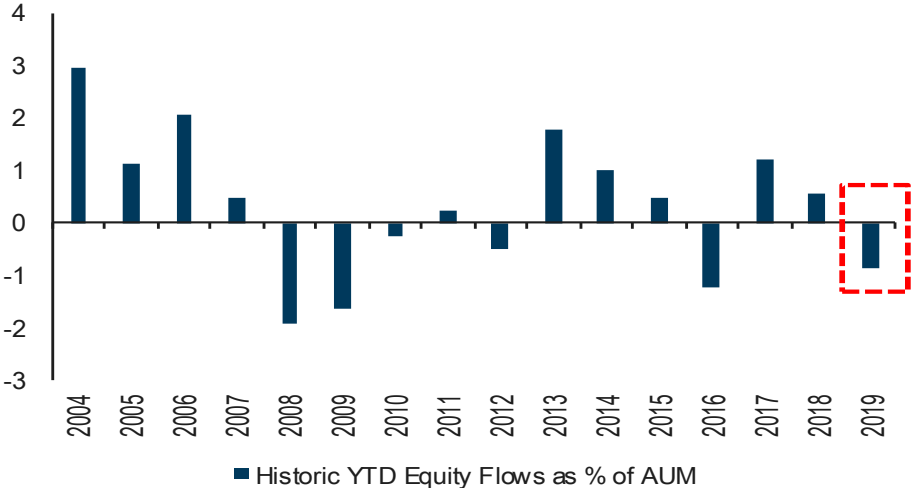


Source: EPFR, Barclays Research

Trading volumes have rolled ytd, but bounce recently

Source: Barclays Research, Bloomberg

Ytd equity outflows after two consecutive years of inflows



Source: EPFR, Barclays Research

Melt-up? Positive catalysts are still missing
No macro recovery in sight for Q4

- The ytd soft patch was sharper and longer than expected. Our economists forecast subdued global growth to continue in Q4.

Barclays forecasts softer global growth in H2 2019

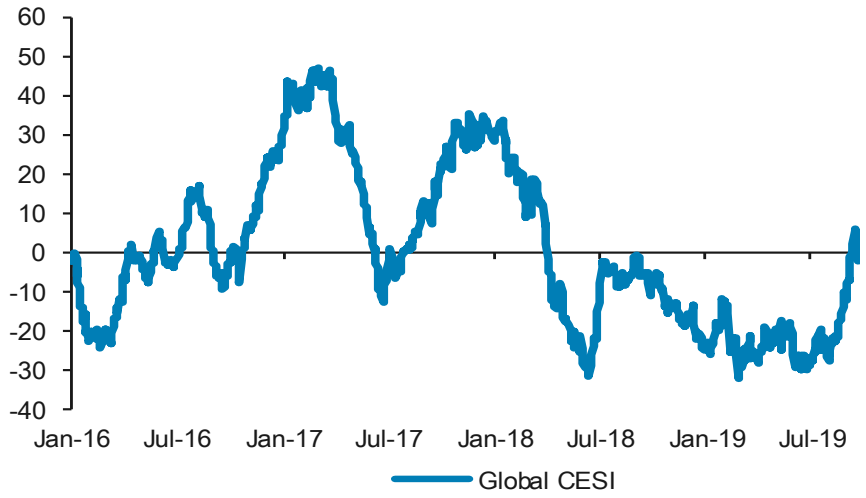
	Real GDP % over previous period, saar					Real GDP % annual change		
	1Q19	2Q19	3Q19	4Q19	1Q20	2018	2019	2020
Global	3.5	2.8	2.6	3.1	3.8	3.9	3.1	3.1
US	3.1	2.0	1.5	1.0	1.5	2.9	2.2	1.6
UK	2.0	-0.8	1.1	0.9	0.7	1.4	1.2	-0.1
Euro Area	1.7	0.8	0.7	1.0	0.9	1.9	1.2	0.8
Germany	1.5	-0.3	-0.6	0.6	0.4	1.5	0.5	0.3
France	1.3	1.3	1.3	1.4	1.1	1.7	1.3	1.1
Italy	0.5	0.1	-0.1	-0.1	0.0	0.7	0.0	0.0
Spain	2.7	1.9	1.4	1.2	0.9	2.6	2.1	1.1
Japan	2.2	1.3	0.7	-2.9	0.6	0.8	0.8	0.3
DM	2.4	1.4	1.2	0.4	0.7	2.2	1.6	1.0
EM	4.3	3.8	3.6	4.9	5.5	5.1	4.1	4.6
China	6.9	5.5	5.2	5.1	5.9	6.6	6.0	5.5
India	4.1	2.9	7.5	10.0	9.0	7.4	5.6	7.4
Brazil	-0.3	1.8	1.4	2.0	1.3	1.1	1.0	2.1
Mexico	-1.0	0.1	2.2	3.2	1.4	2.0	0.5	1.5
Russia	1.5	-2.2	2.9	2.0	-0.1	2.3	1.0	2.0

Source: Barclays Economic Research

Not all is bad: money supply is stabilising, eco surprises are bouncing…

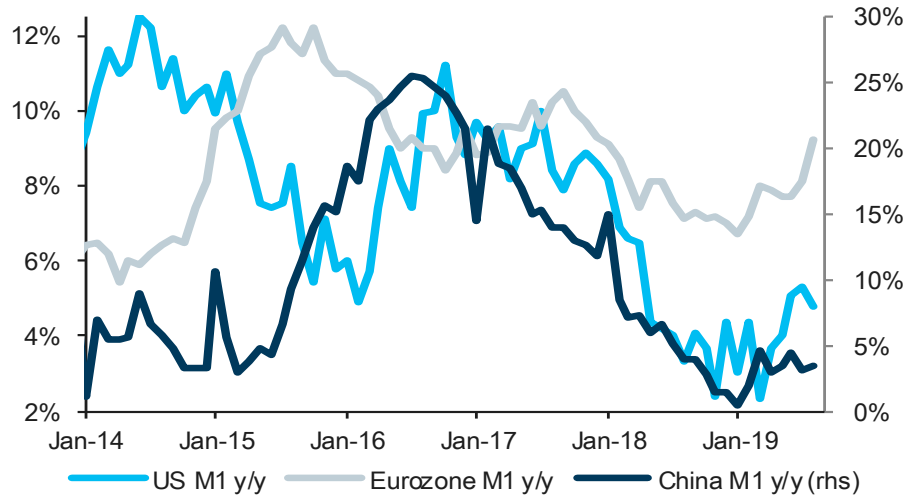
- Global economic surprises have rebounded from depressed level recently, as expectations have been materially lowered over the past months.
- Measures of money supply rolled over sharply in all the main regions last year – US, China and Europe – as central banks unwound QE and/or tightened policy. However, the trend is reversing now as all the key central banks are in easing mode.
- We note that in the Eurozone, M1 growth, which is a good leading indicator of PMIs, stabilised most recently, which we see as a positive development for the activity outlook.

Global CESI is trending upwards



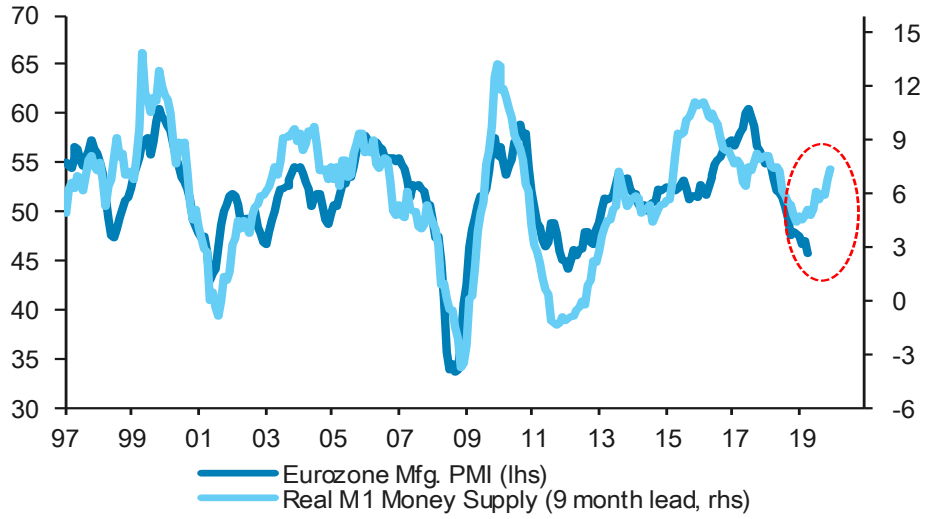
Source: Bloomberg

Money supply appears to be stabilizing across all major regions



Source: Bloomberg

M1 growth is rebounding in the Eurozone, which bodes well for PMIs

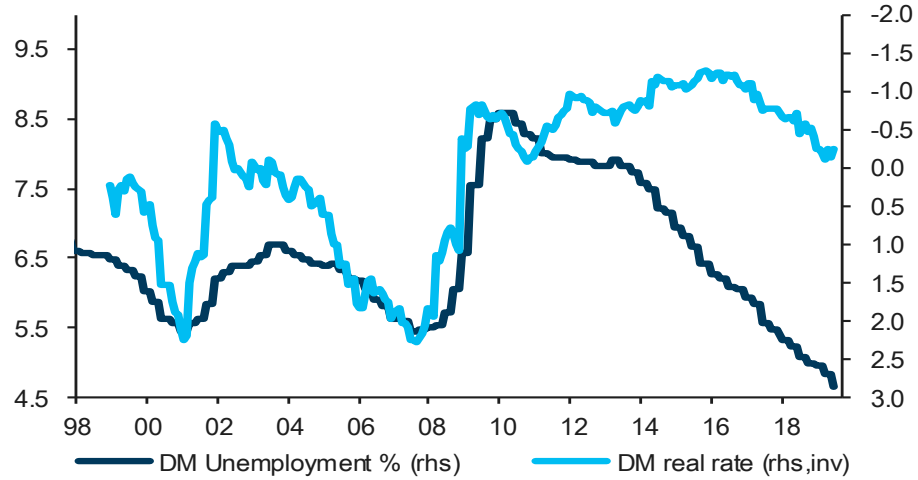


Source: Markit, ECB, Bloomberg, Datastream

…and drivers of the consumer are well oriented in US / Europe…

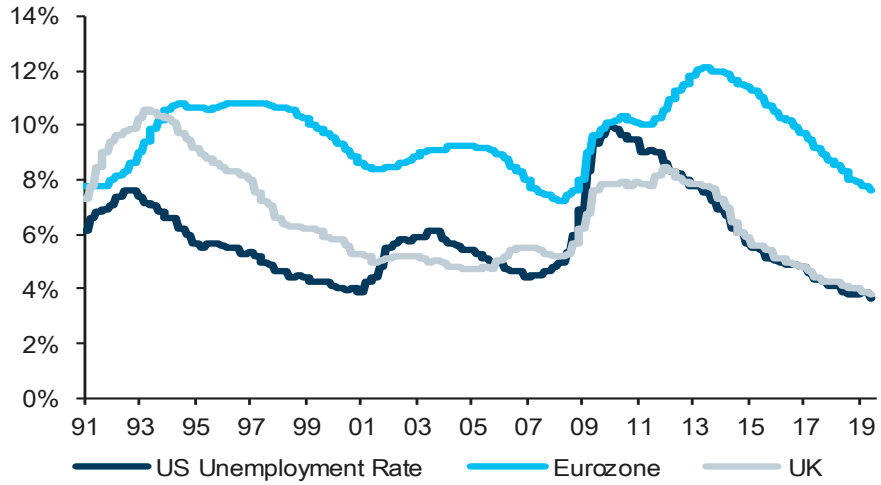
- While external demand and manufacturing are under pressure, the domestic drivers of growth in US and Europe remain well oriented.
- Real rates are negative while the unemployment rate is at cycle lows.
- In the meantime, wage growth remains healthy, which is supportive of higher consumer disposable income.

Unemployment rate is at cycle lows



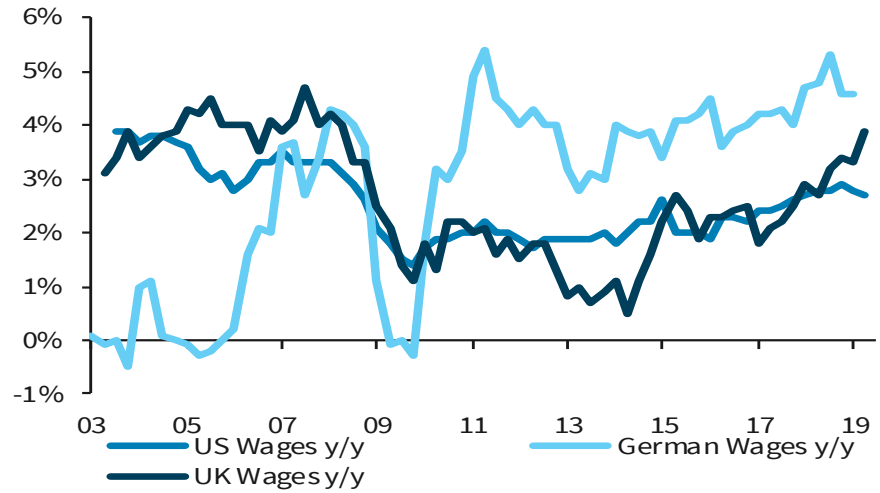
Source: Bloomberg, Datastream

Negative real rates and low unemployment are a good mix for DM growth



Source: Bloomberg

Wage growth is on the rise

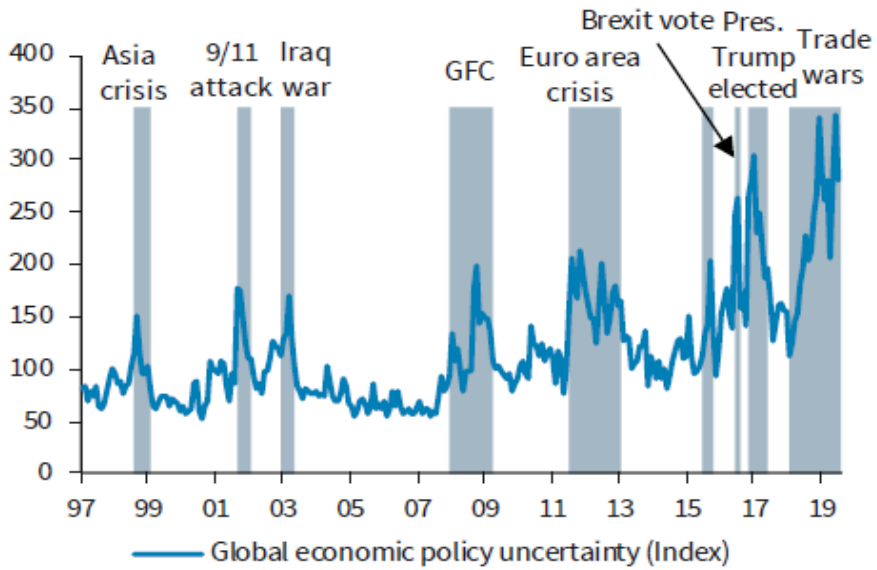


Source: Bloomberg

…but persistent uncertainty remains a key drag on growth

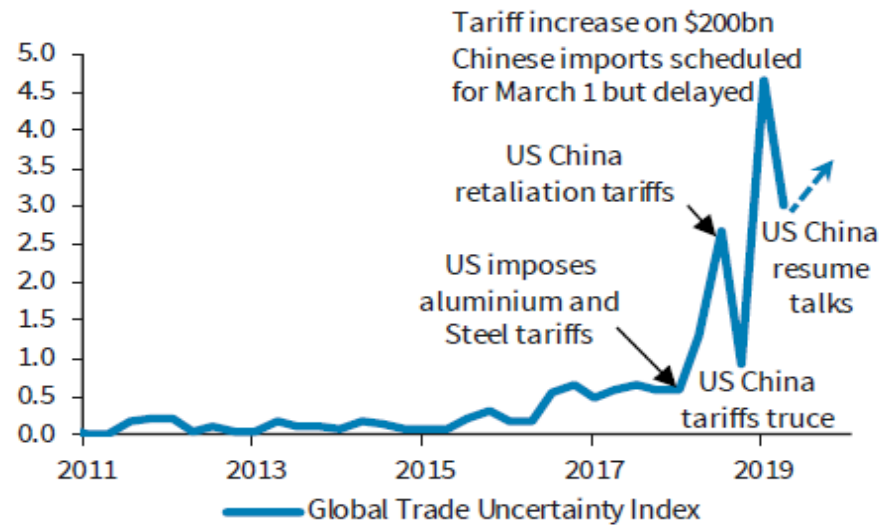
- However, persistent geopolitical uncertainty, mostly over US-China trade and Brexit, continues to weigh on the global outlook.
- Although the volatile news flow leaves room for optimism, we believe the patterns so far vindicate our scepticism about the likelihood of sudden deals for US-China trade or Brexit.

Policy uncertainty is at decade highs



Source: Policyuncertainity.com, Haver

It has a lot to do with trade policy

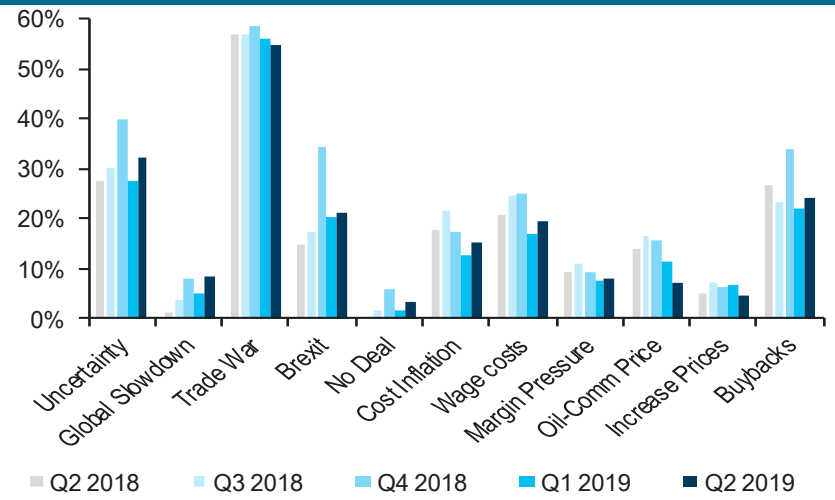


Source: Policyuncertainity.com, Haver

Companies are increasingly concerned about trade war and Brexit

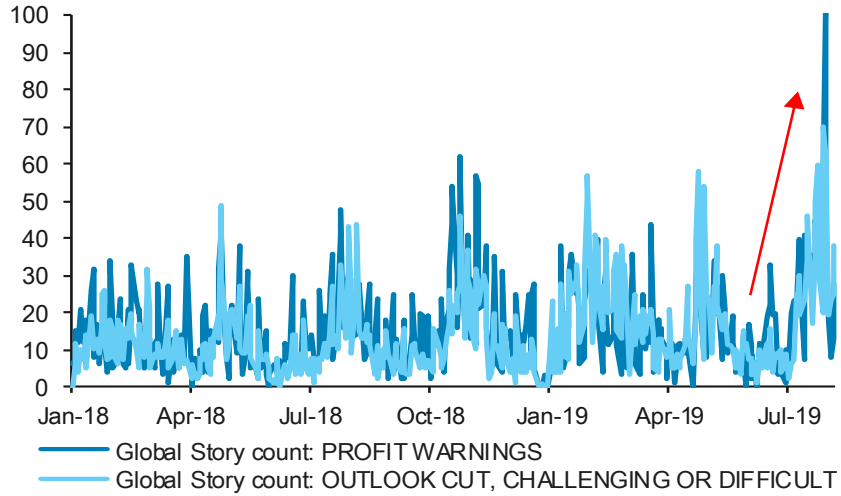
- Our analysis of 2000+ transcripts after the Q2 reporting season showed that the US-China trade war is the biggest concern, for over half of companies.
- Worries about Brexit went up, along with the likelihood of a No Deal.
- Rising labour costs, tougher competition and the cost of innovation are seen as headwinds for profit margins, but spending in digitalisation is still considered as both necessary and positive, while the appetite for buybacks is intact.

What companies discussed the most with Q2 results



Source: Barclays Research, Bloomberg,

Profit warnings increased markedly in Q2



Source: Barclays Research, Bloomberg

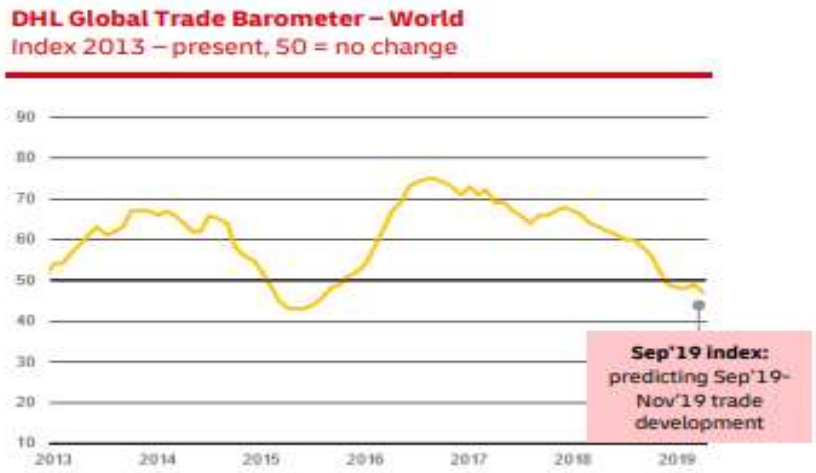
Summary of Q2 discussion and sentiment

Q2 2019	Positive	Neutral	Negative
Global Economy	33%	28%	40%
China	45%	17%	38%
Trade Wars	5%	31%	64%
Brexit	10%	30%	60%
Margins	22%	22%	56%
Labour Costs	25%	19%	56%
Digitalisation	76%	20%	4%
Capex	26%	60%	14%
Buybacks	80%	20%	0%

Source: Barclays Research, company transcripts

The global manufacturing slump has a lot to do with the trade war…

DHL global trade barometer down further in September

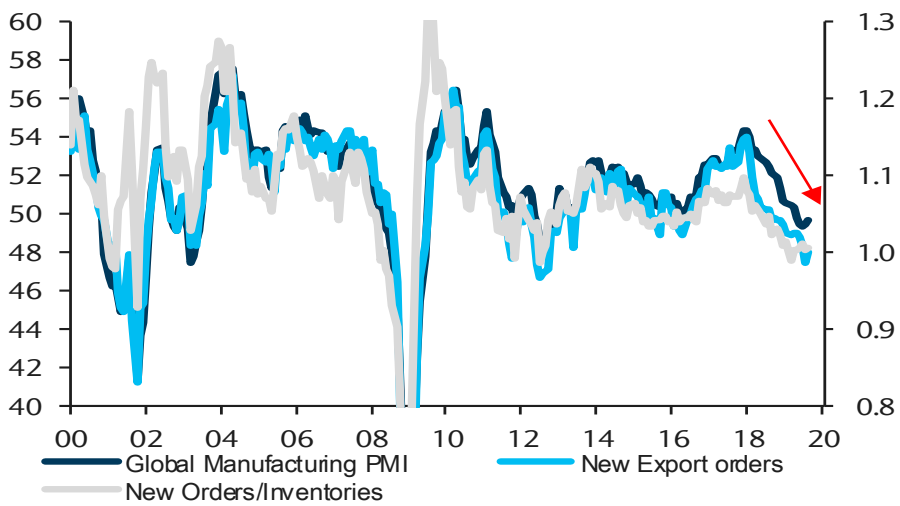


Source: Barclays Research, DHL

Global trade and manufacturing has continued to weaken

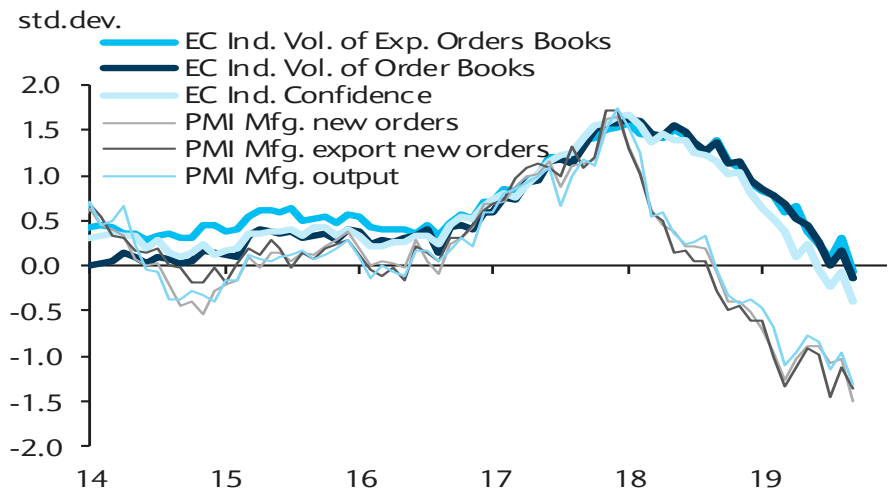
Source: Barclays Economic Research, Markit, Bloomberg

Manufacturing PMIs have rolled over sharply..



Source: Markit, Bloomberg

...particularly in the Eurozone

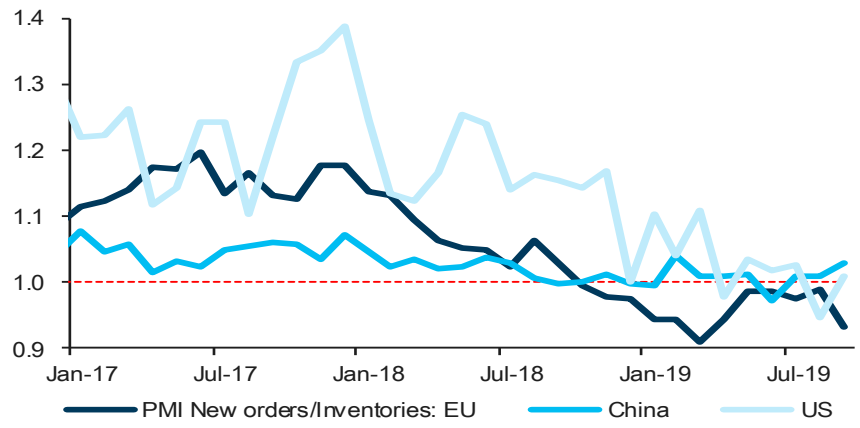


Source: Markit, Bloomberg

…and is starting to spread to services

- Manufacturing has borne the brunt of the trade slowdown and continues to decelerate globally.
- Services generally remain healthy but are seeing slowdown too.
- New orders to Inventory ratios declined in China into Q1 but have recently stabilised in both China & US. EU continues to deteriorate though.
- Overall the picture remains weak, and the rumbling trade war increases the downside risk to the global economy.

New order to inventories are declining in EU but stable in US & China



Source: Bloomberg, Markit

Manufacturing PMIs are weakening across the board..

	US ISM	Eurozone	UK	Japan	China	EM
May-18	58.7	55.5	54.3	52.8	51.1	51.1
Jun-18	60.0	54.9	54.0	53.0	51.0	51.2
Jul-18	58.4	55.1	53.9	52.3	50.8	51.0
Aug-18	60.8	54.6	52.9	52.5	50.6	50.8
Sep-18	59.5	53.2	53.7	52.5	50.0	50.3
Oct-18	57.5	52.0	51.1	52.9	50.1	50.5
Nov-18	58.8	51.8	53.3	52.2	50.2	50.7
Dec-18	54.3	51.4	54.3	52.6	49.7	50.3
Jan-19	56.6	50.5	52.8	50.3	48.3	49.5
Feb-19	54.2	49.3	52.1	48.9	49.9	50.6
Mar-19	55.3	47.5	55.1	49.2	50.8	51.0
Apr-19	52.8	47.9	53.1	50.2	50.2	50.5
May-19	52.1	47.7	49.4	49.8	50.2	50.4
Jun-19	51.7	47.6	48.0	49.3	49.4	49.9
Jul-19	51.2	46.5	48.0	49.4	49.9	50.1
Aug-19	49.1	47.0	47.4	49.3	50.4	50.4
Sep-19	47.8	45.7	48.3	48.9	51.4	

Source: Haver

…while services PMIs are cooling down too

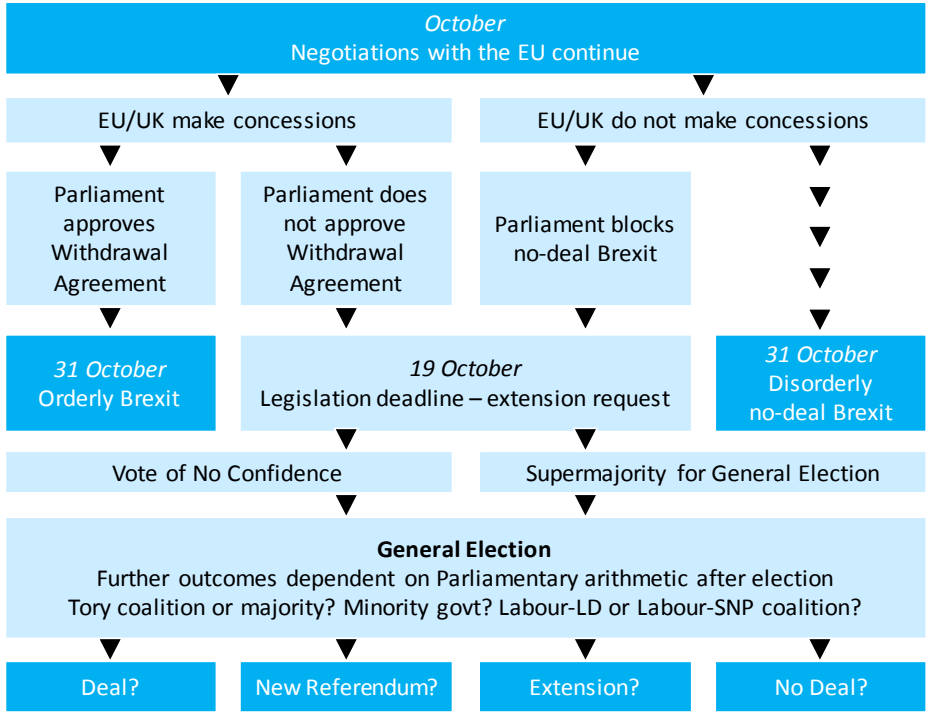
	US ISM	Eurozone	UK	Japan	China	EM
May-18	58.9	53.8	54.0	51.0	52.9	52.5
Jun-18	58.7	55.2	55.1	51.4	53.9	52.6
Jul-18	56.7	54.2	53.5	51.3	52.8	52.9
Aug-18	58.8	54.4	54.3	51.5	51.5	51.6
Sep-18	60.8	54.7	53.9	50.2	53.1	52.1
Oct-18	60.0	53.7	52.2	52.4	50.8	51.9
Nov-18	60.4	53.4	50.4	52.3	53.8	53.8
Dec-18	58.0	51.2	51.2	51.0	53.9	53.6
Jan-19	56.7	51.2	50.1	51.6	53.6	52.9
Feb-19	59.7	52.8	51.3	52.3	51.1	52.1
Mar-19	56.1	53.3	48.9	52.0	54.4	53.7
Apr-19	55.5	52.8	50.4	51.8	54.5	53.2
May-19	56.9	52.9	51.0	51.7	52.7	51.7
Jun-19	55.1	53.6	50.2	51.9	52.0	51.5
Jul-19	53.7	53.2	51.4	51.8	51.6	52.1
Aug-19	56.4	53.5	50.6	53.3	52.1	52.3
Sep-19		52.0				

Source: Haver

Brexit: Deal still possible, but delayed no-deal remains the by-default option

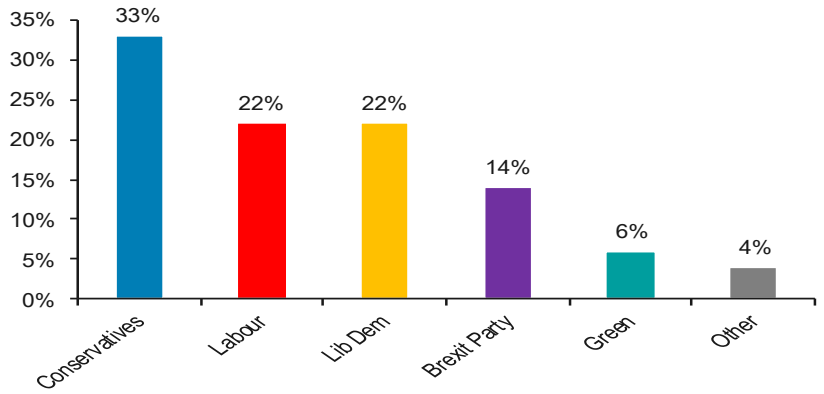
- Our house view is for an A50 extension at the end of October, followed by a No Deal Brexit at the end of January 2020. The current government sees delivering Brexit as a political imperative.
- However, the PM is facing a narrowing range of options to deliver his promise to leave the EU by 31 October. As a no-deal will likely be stopped by parliament, the government might be willing to compromise and negotiate an agreement with the EU.

Potential Brexit scenarios



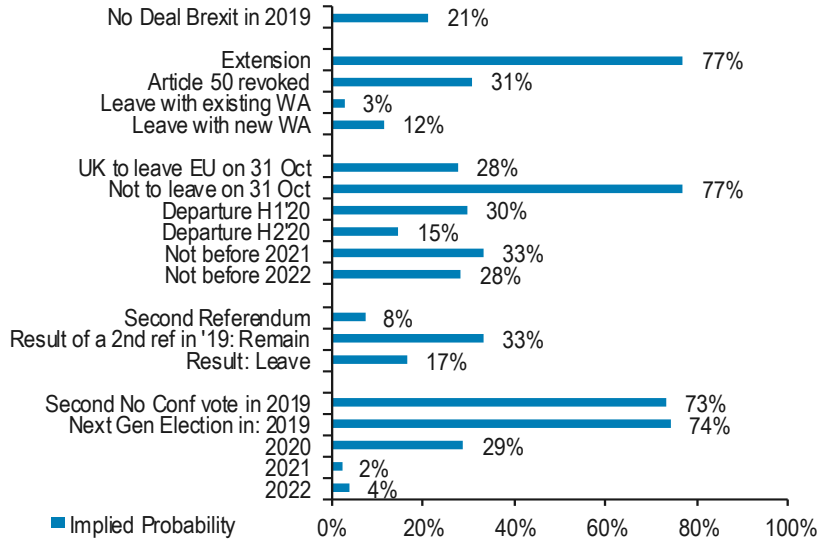
Source: Barclays Research

UK general election polls



Source: YouGov published 24-25 Sep 2019; Note: Westminster voting intention – if there was a general election held tomorrow, which party would you vote for?

Implied probability of No Deal is around 20%



Source: Barclays Research, Oddschecker.com. Note: Data is calculated as the arithmetic average of the implied probability of each event for bookmakers where odds are available on Oddschecker, as of 1 October 2019

US-China trade war: Talks are welcome, but a deal may not happen quickly

- The market welcomed the recent news that China and the US had agreed a date to restart trade talks in October, which, coupled with earlier signs of some détente between them helped fuel the rebound in risk appetite and gave a boost to trade related stocks.
- Impeachment noise and falling approval ratings on Trump's handling of the economy suggest that the President may favour an interim trade deal over escalation. However, given the on-again, off-again nature of the talks and previous direction of travel (escalation rather than de-escalation), we are not expecting a quick turnaround in trade volumes and hence manufacturing activity.

US-China tariffs timeline

Jul'18

10 Jul
$200bn list

Aug-Sep'18

20-27 Aug
$200bn public hearing

24 Sep
10% on $200bn effective

24 Sep
5-10% on $60bn effective

Nov'18-Feb'19

1 Nov
Xi-Trump phone call

1 Dec
G20 truce; delayed tariff hikes on $200bn

24 Feb
Tariff hikes on $200bn delayed

May'19

5 May
Trump tweets to raise tariffs on $200bn; tariff threat on $325bn

10 May
$200bn tariff raised to 25%, products entered before 1 Jun are exempt

13 May
$300bn list

15 May
US blacklist Huawei

31 May
USTR extends deadline of $200bn tariff hike to 15 June

31 May
Plan to release Unreliable Entity List

Jun-Jul'19

15 Jun
$200bn tariff hike effective

17-21, 24-25 Jun
$300bn hearing

18 Jun
Xi-Trump phone call

1 Jun
$60bn tariff hike effective

17 Jun
China announces Xi's visit to North Korea

28-29 Jun
G20 truce; pause new tariffs, lift Huawei ban

30 Jun
Trump stepped into North Korea

2 Jul
$300bn post-hearing

20-21 Jun
Xi visits North Korea

Aug'19

1 Aug
Trump announces 10% tariff on $300bn from 1 Sep

5 Aug
Trump labels China as a "currency manipulator"

13 Aug
Of $300bn, $160bn consumer tech tariffs delayed to Dec

23 Aug
Trump hikes to 15% tariffs on $300bn, 30% on $250bn

5 Aug
China asks state-owned companies to suspend US agricultural imports

23 Aug
China announces additional tariffs on $75bn US goods, inc. hiking tariffs on cars

Sep'19

1 Sep
15% tariffs on $125bn effective

5 Sep
Next round of trade talks agreed for October

12 Sep
Two-week delay announced on $300bn hike

1 Sep
$75bn tariffs effective, inc. 5% on US crude oil

11 Sep
Exemption list for some US imports

Oct-Dec'19

15 Oct
Delayed 30% tariffs on $250bn effective

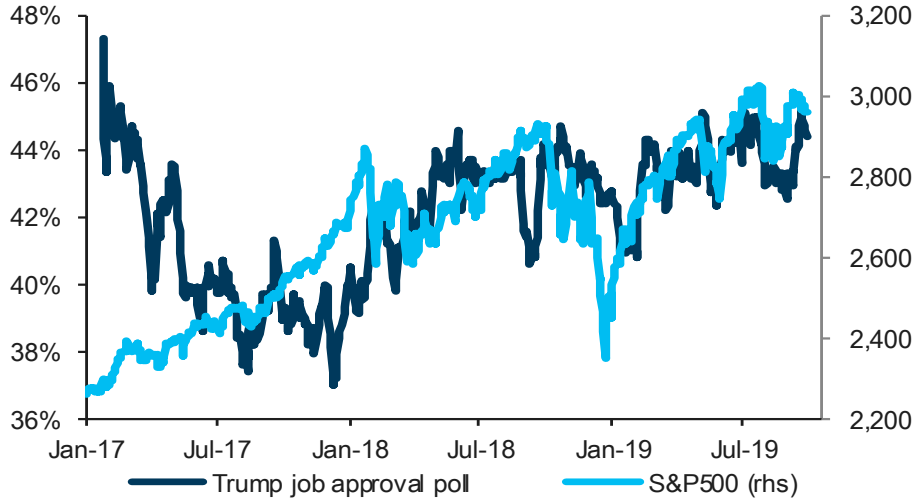
16-17 Nov
APEC Chile

15 Dec
$160bn tech tariffs effective

Source: Barclays Economists: China-US trade talk: A ceasefire of mutual interest (30 June 2019 original, updated for latest developments)

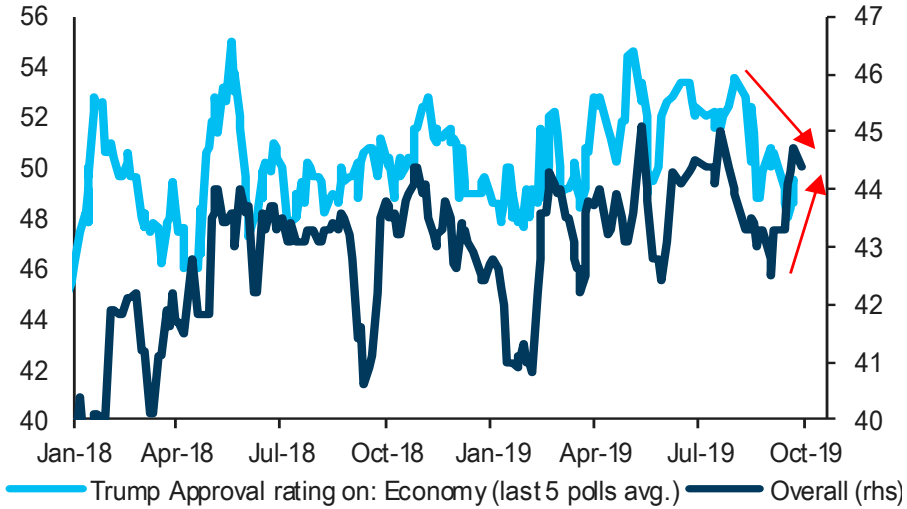
Trump's approval ratings are holding up; Warren is taking the lead for Democrats

Trump approval ratings have rebounded with S&P500...



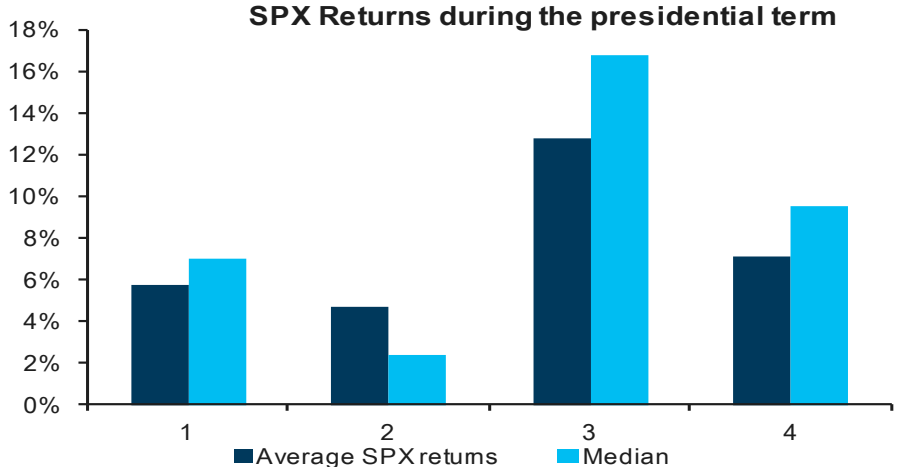
Source: Bloomberg, Real clear politics

...but his economic approval ratings are falling



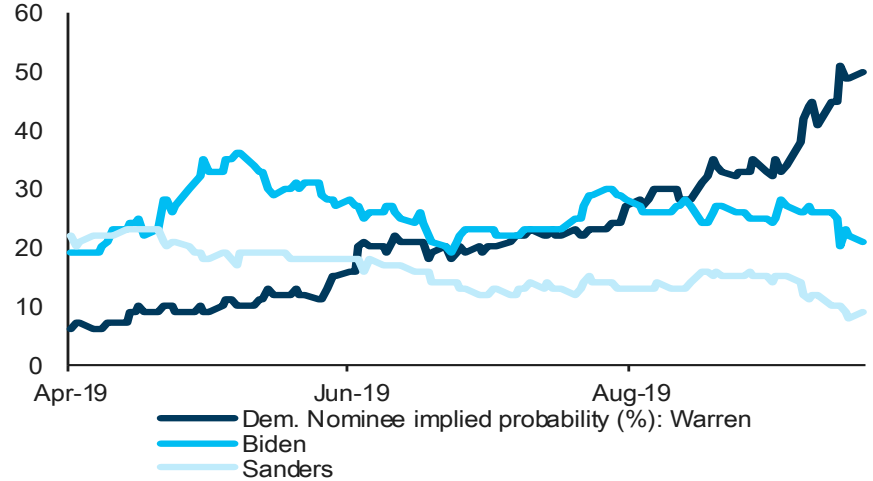
Source: Bloomberg, Real clear politics

The third year of presidential terms is typically the strongest for S&P500 returns



Source: Barclays Research; Note: Year-4 is Presidential election year, since 1928

Warren's nomination probability has surged recently

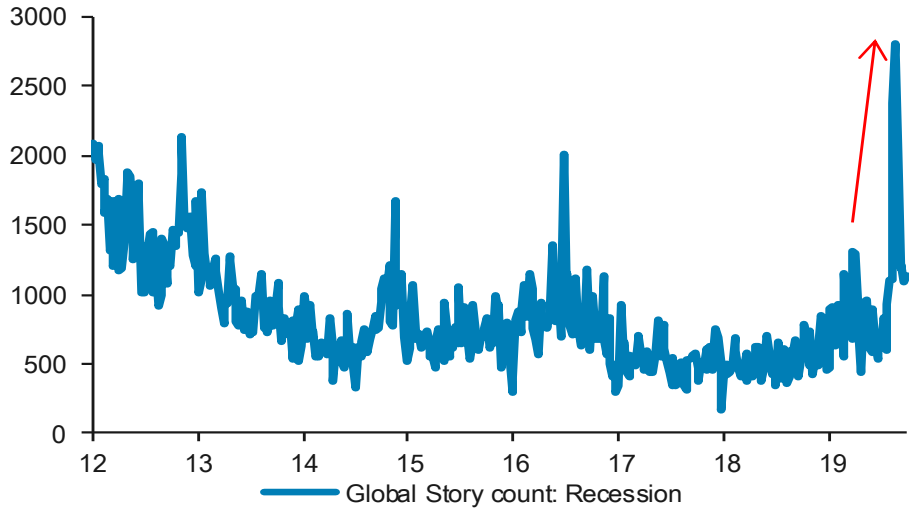


Source: Bloomberg, PredictIt

US: Recession fears are growing

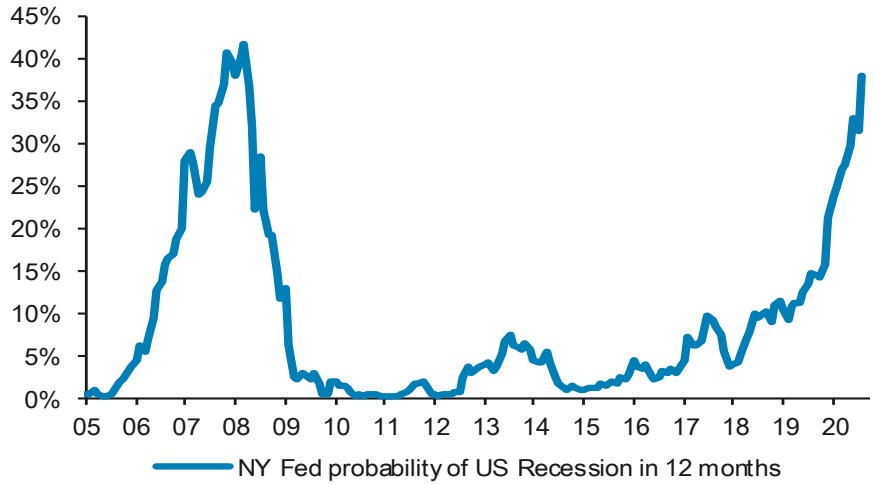
- Many pundits appear to consider a US recession as a base case now, even though its timing is uncertain.
- According to the New York Fed, the probability of a recession happening in the US over the next 12 months stands at 38% currently, which is the highest level in more than ten years.
- The number of news articles mentioning the word recession has also surged recently.

Recession story count has surged



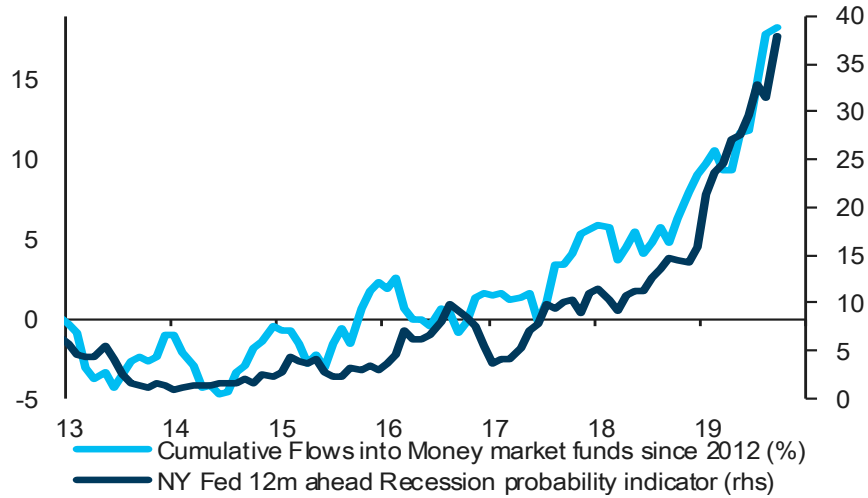
Source: Bloomberg, Barclays Research

NY Fed probability of US recession in 12 months is the highest in ten years



Source: Bloomberg, NY Fed

Allocation to cash has been rising along with the growing recession probability

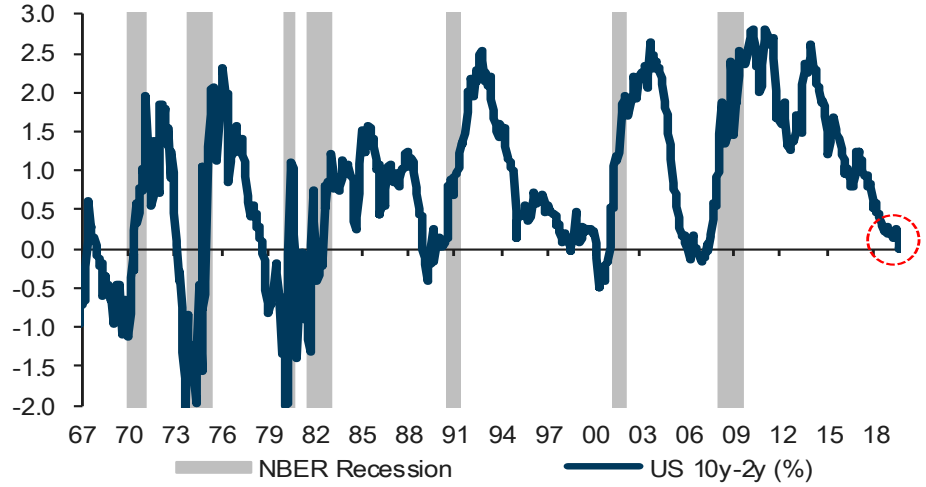


Source: EPFR, Barclays Research, Bloomberg

Inverted yield curve is a serious red flag…

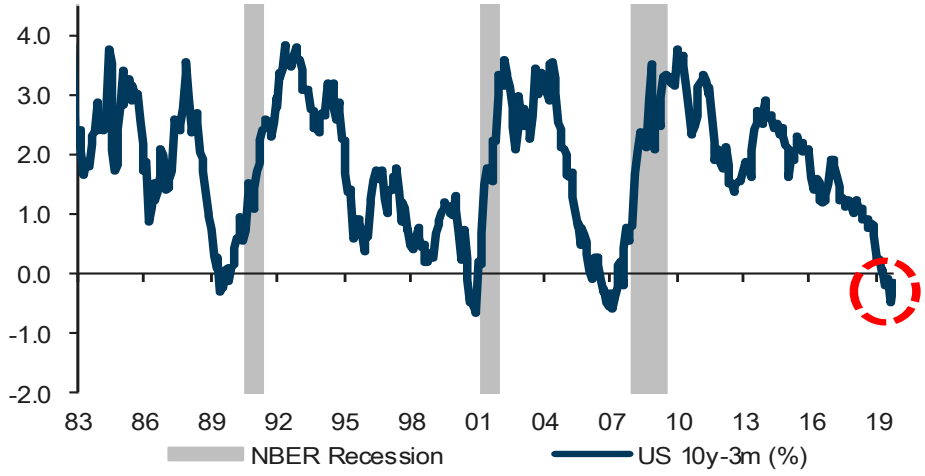
- The shape of the US yield curve is at the centre of the cycle debate. The current spread between 10Y and 2Y bond yields has moved below zero, as did the 10Y-3M spread earlier this year.
- Many see an inverted yield curve as a key red flag for the US economy.
- Indeed, every time the yield curve inverted in the last 50 years, a recession followed, without any false signals.

10-2y US curve inverted recently



Source: Bloomberg, Barclays Live

10y-3m yield curve is also inverted



Source: Bloomberg, Barclays Live

…but doesn't necessarily mean lower equities, at least in the short term

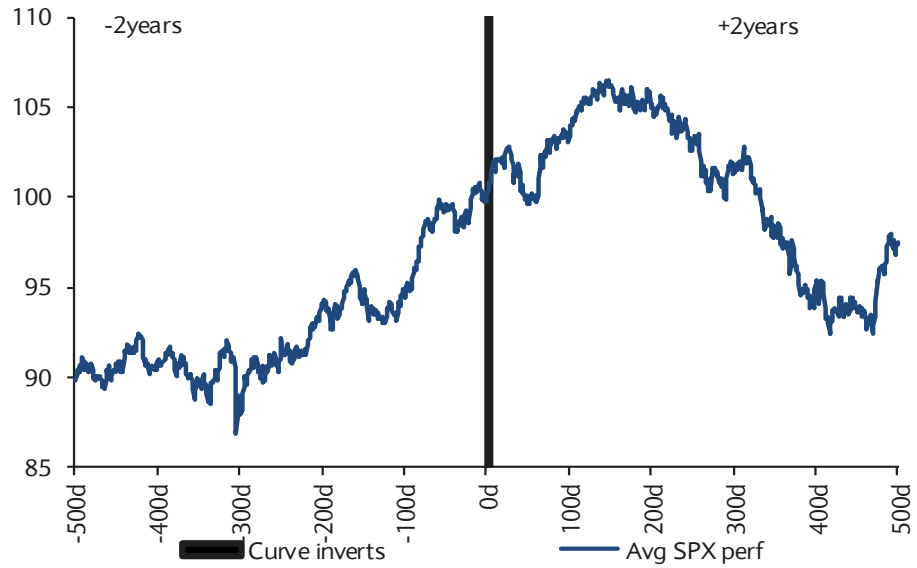
- The 10-2Y yield curve typically inverted when the business cycle was 70-75% advanced, and thus it did not mark the end of the cycle.
- Equities always peaked some time after the yield curve inverted, by 11 months on average. Their average performance up to the peak was 13%.

Timing of past yield curve inversions, equity markets peaks and recessions

Start of US upcyle	Date of 10-2Y Curve Inversion	Date of S&P500 peak	Start of US Recession	# of months b/w curve inversion & SPX peak	# of months b/w SPX peak & recession	# of months b/w curve inversion & recession	% of cycle when curve inverts	% of cycle when SPX peaks	Perf b/w curve inversion & SPX peak
Mar-61	Dec-67	Nov-68	Dec-69	11	13	24	77%	88%	12%
Dec-70	Mar-73	Sep-73	Nov-73	6	2	8	77%	94%	-3%
Apr-75	Aug-78	Jan-80	Jan-80	17	0	17	70%	100%	11%
Jul-80	Sep-80	Nov-80	Jul-81	2	8	10	17%	33%	12%
Dec-82	Dec-88	Jun-90	Jul-90	18	1	19	79%	99%	29%
Apr-91	Feb-00	Aug-00	Mar-01	6	7	13	89%	94%	11%
Dec-01	Aug-06	Oct-07	Dec-07	14	2	16	78%	97%	19%
Average				**11**	**5**	**16**	**70%**	**86%**	**13%**

Source: Datastream, NBER

Stocks continued to rise after the curve inverted

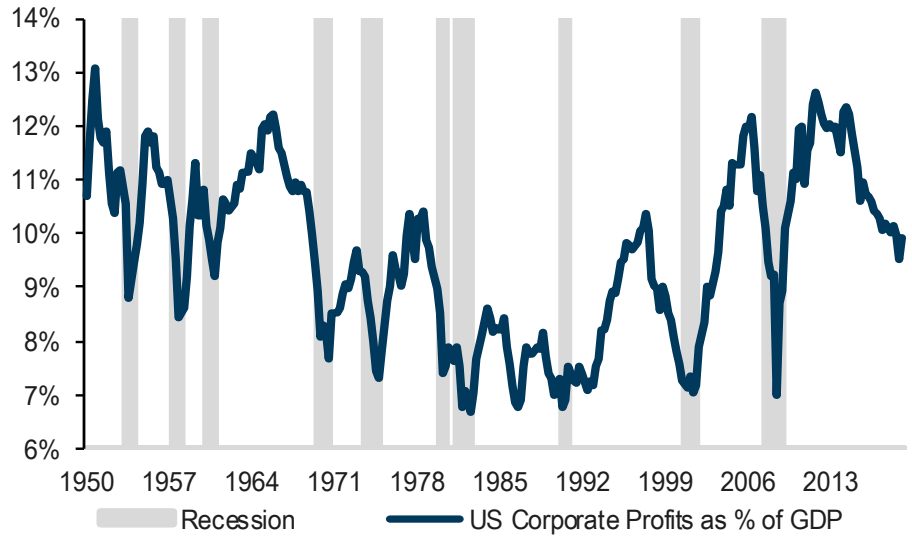


Source: Barclays Research

Falling NIPA margins is another serious concern

- Following the recent annual revision to US NIPA estimates by the BEA, US profit margins look much weaker than initially thought.
- The revisions subtracted income from corporate profits and boosted employee compensation, resulting in a lower corporate profit share of GDP.
- The peak in profit margins always preceded past US recessions.

US corporate profit share of GDP is rolling over…



Source: BEA, NBER

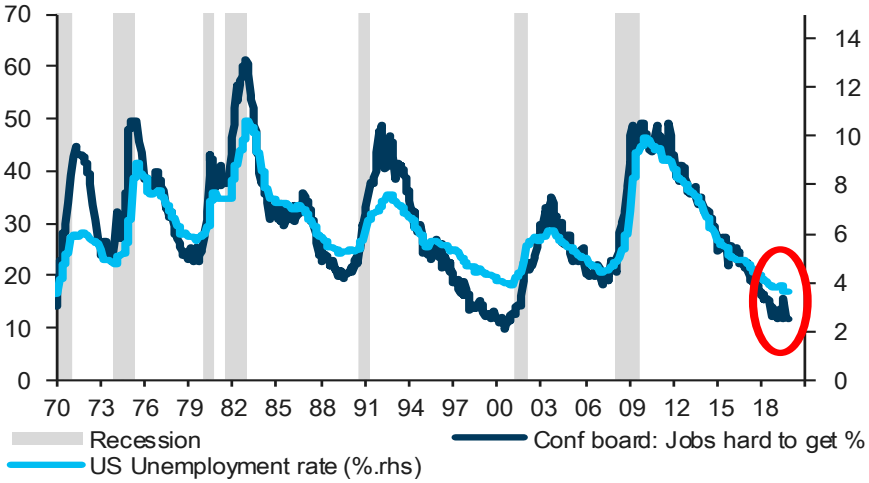
…which typically precedes recessions

Margins peak date	Recession start date	Cycle peak in margins	Level @ start of recession (as % of peak margin)	# of Qtr's from peak margins to recession
Q4 '50	Q3 '53	13.1%	81%	8
Q2 '55	Q3 '57	11.9%	87%	7
Q2 '59	Q2 '60	11.3%	90%	3
Q1 '66	Q4 '69	12.2%	73%	11
Q1 '73	Q4 '73	9.7%	95%	2
Q4 '78	Q1 '80	10.4%	82%	4
Q3 '81	Q3 '81	7.9%	100%	0
Q1 '84	Q3 '90	8.6%	79%	20
Q3 '97	Q1 '01	10.4%	69%	11
Q3 '06	Q4 '07	12.2%	83%	4
Q1 '12		*12.6%*	*75% of peak at current level*	
Median		**10.9%**	**82%**	**5**
Average		**10.8%**	**84%**	**7**

Source: Barclays Research

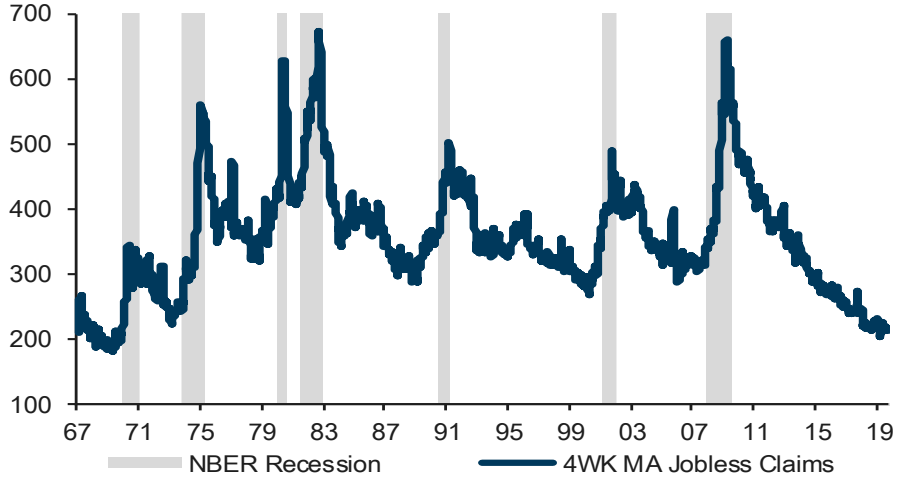
Labour market holds the key…

US unemployment rate is at historical lows



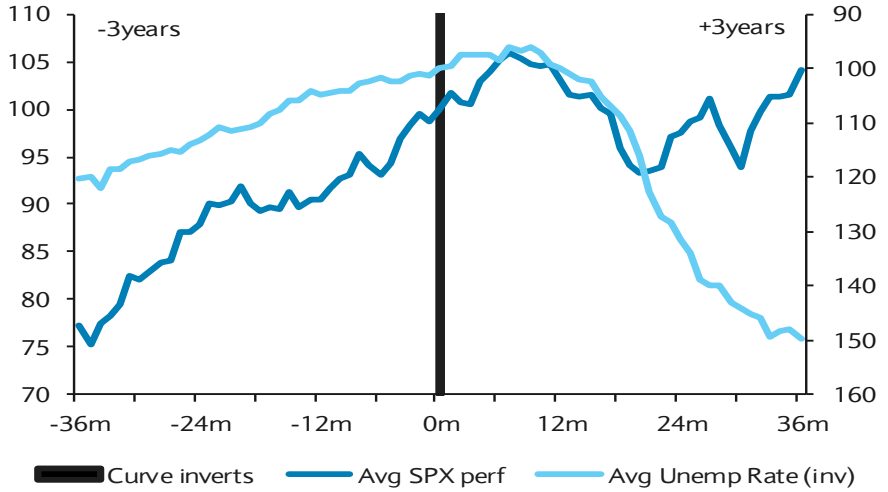
Source: Bloomberg, NBER

US jobless claims remain well behaved



Source: Datastream, NBER

The trough in UR typically coincides with the peak in equities



Source: BEA, Datastream

Time lag between trough in unemployment rate and recessions

Start of US upcyle	Start of US Recession	Date of UE trough	Level of UE trough	# of months b/w UE trough & recession
Mar-61	Dec-69	Sep-68	3.4%	15
Dec-70	Nov-73	Oct-73	4.6%	1
Apr-75	Jan-80	May-79	5.6%	8
Jul-80	Jul-81	Dec-80	7.2%	7
Dec-82	Jul-90	Mar-89	5.0%	16
Apr-91	Mar-01	Apr-00	3.8%	11
Dec-01	Dec-07	May-07	4.4%	7
Latest		*Apr-19*	*3.6%*	
Median			**4.6%**	**8**
Average			**4.9%**	**9**

Source: Bloomberg, NBER

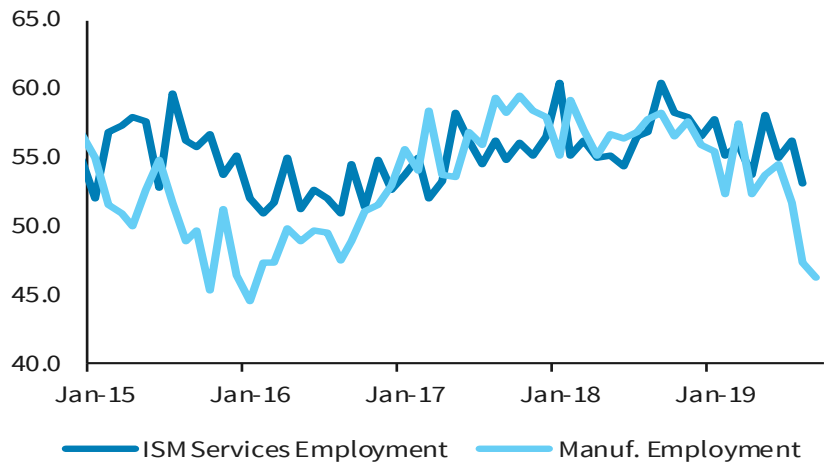
…some cracks are showing

- There is evidence of a slowing US labor market. The August payroll report showed job gains of just 130K (vs a consensus of 160K), and that includes a temporary census-related increase of 25K.
- More importantly, recent revisions to employment data paint a picture of a labor market that is cooling off.
- Also, the employment sub-indices fell for both manufacturing and non-manufacturing ISM surveys

Job gains have slowed down much more so than the prerevision data suggested

Source: Barclays Economic Research

ISM surveys employment components are weakening



Source: Bloomberg, ISM

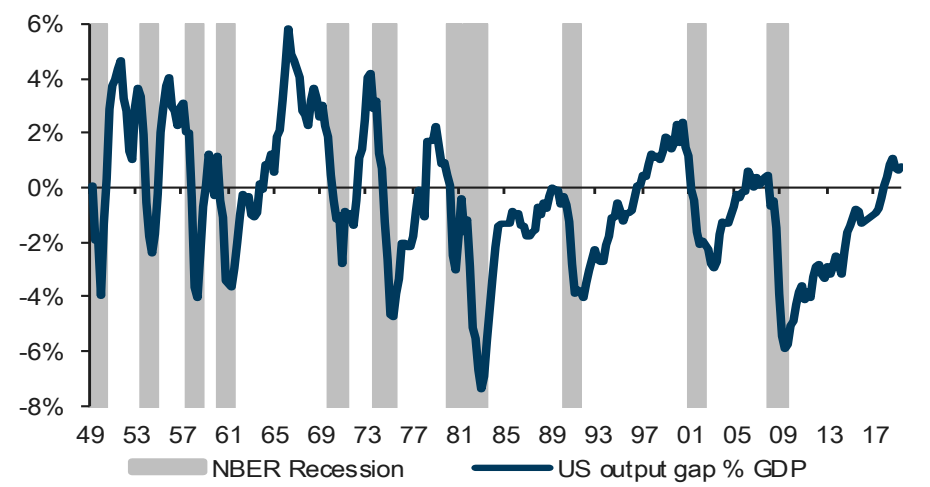
Large gap between consumer and business confidence

Source: Barclays Economic Research

Real rates are still depressed, though…

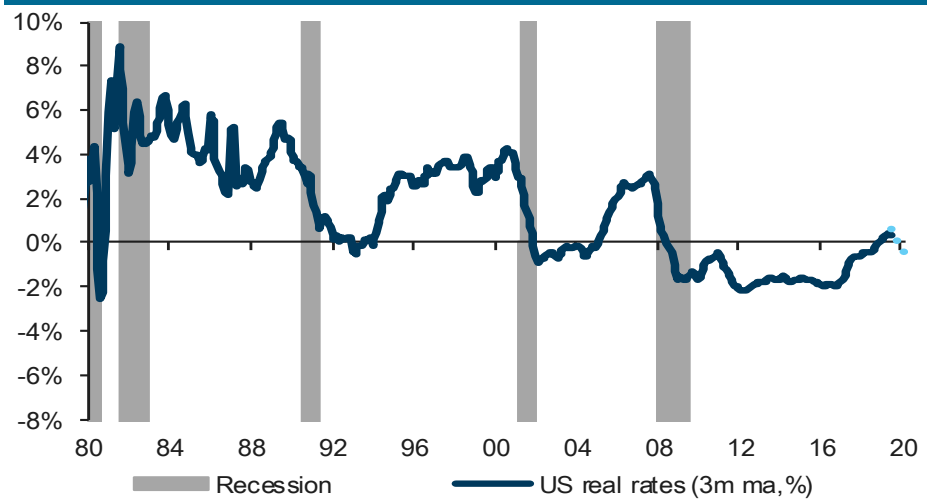
- Business cycles do not die of old age, but many US activity indicators are well above their previous peak at present.
- The concern in Q4'18 was that the Fed turned more restrictive while the US economy disappointed. The gap between the level of rates and the level of nominal GDP growth narrowed in the last three years.
- However, with real rates still close to negative, we do not see them as a threat to the business cycle, yet. With rates now at 2%, the Fed still has room to ease policy.

US output gap is positive



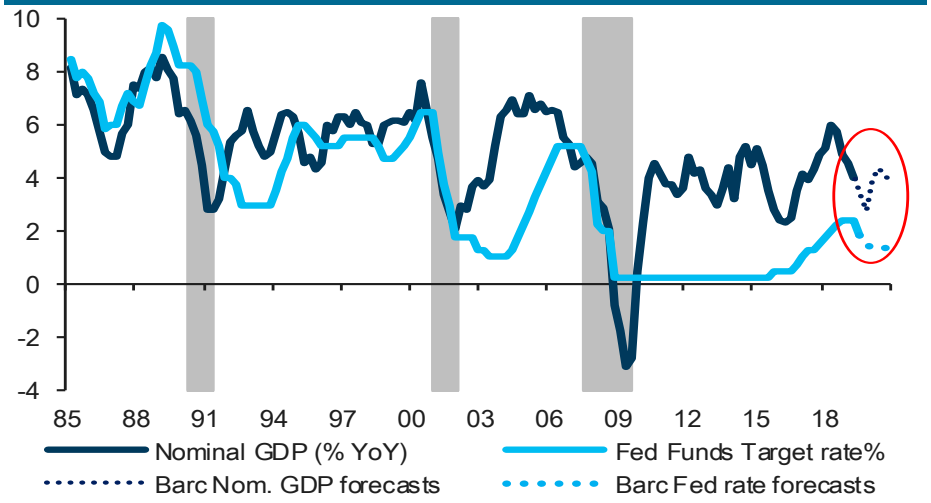
Source: CBOE, NBER, Bloomberg

US Real Fed Funds rates are barely positive



Source: Bloomberg, dotted line denotes Barclays Research forecasts

The gap between US rates and GDP growth is still positive

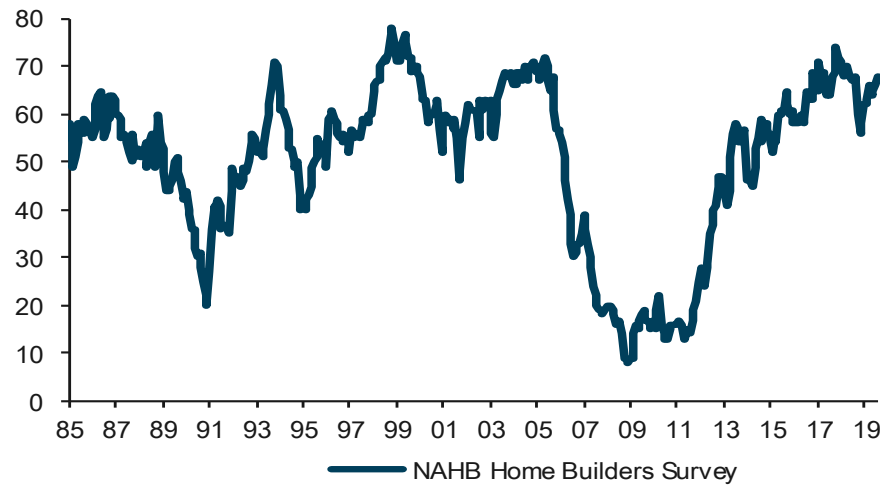


Source: Bloomberg, Barclays Economics Research

…financing conditions and housing are improving again…

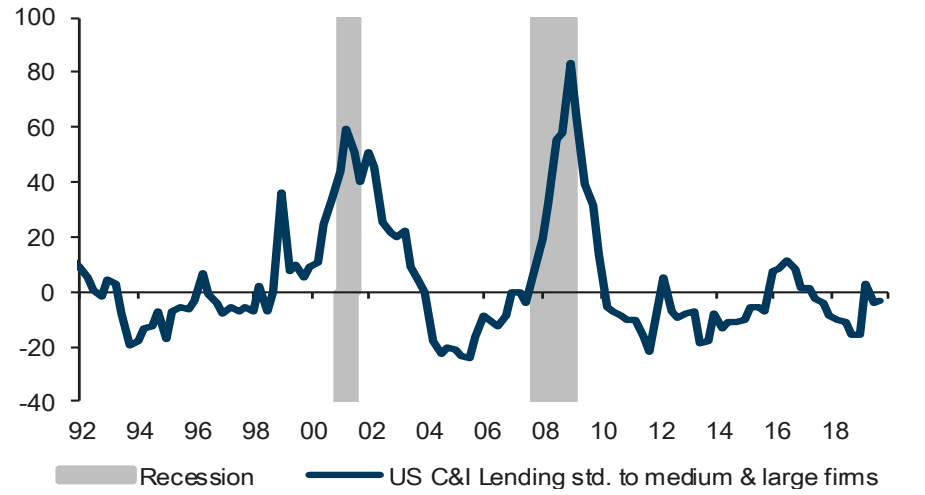
- Recent indicators in rate-sensitive parts of the economy such as housing have recovered.
- Bank lending standards were tightened in Q4'18, but have eased again since then.

NAHB housing survey recovered recently



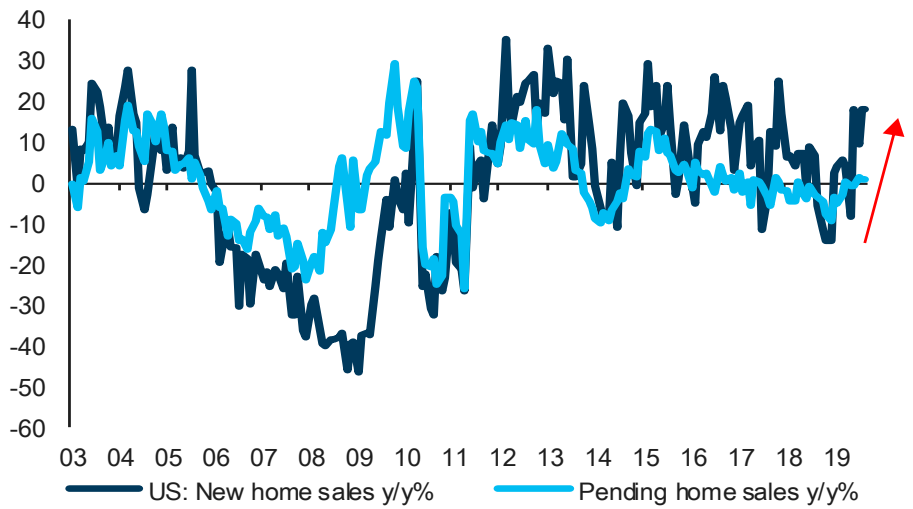
Source: Bloomberg

US banks lending standards remain low in Q3



Source: Datastream, NBER

US homes sales (new and pending) are rebounding

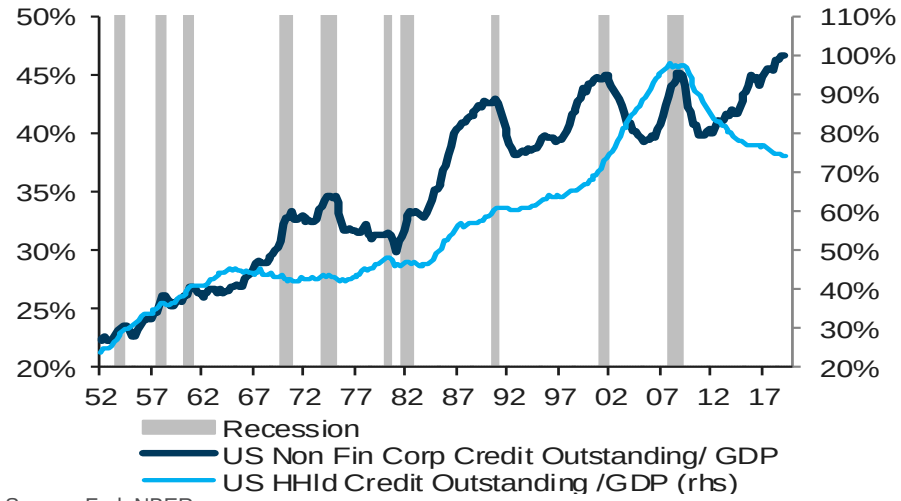


Source: Bloomberg

…and credit markets are not showing much stress

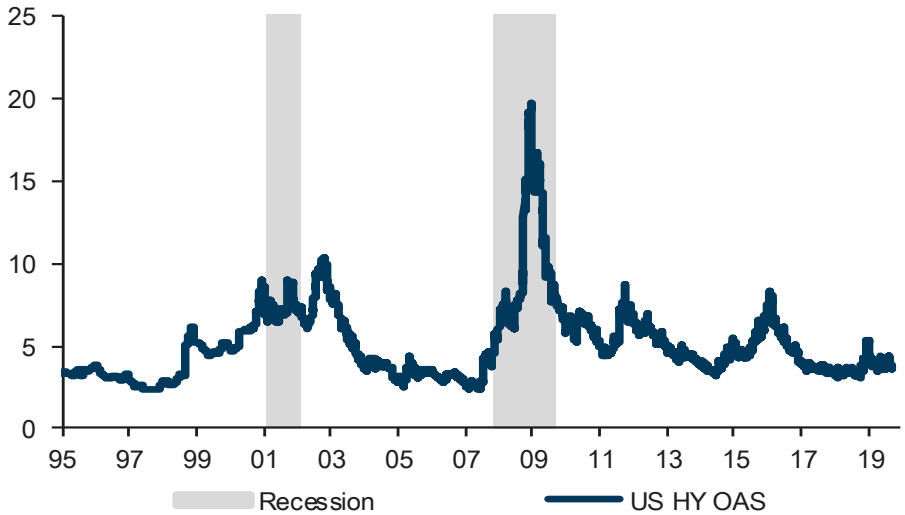
- Elevated corporate leverage is a potential risk, but household leverage is well below the previous peak.
- Corporate credit spreads typically surge higher as we enter into an recession.
- Currently, US HY credit spreads are much lower than the levels seen during the debt crisis in 2012-13 and then during 2015-16. The current levels are in fact closer to cyclical lows.

US corporate leverage has increased, but household leverage has gone down



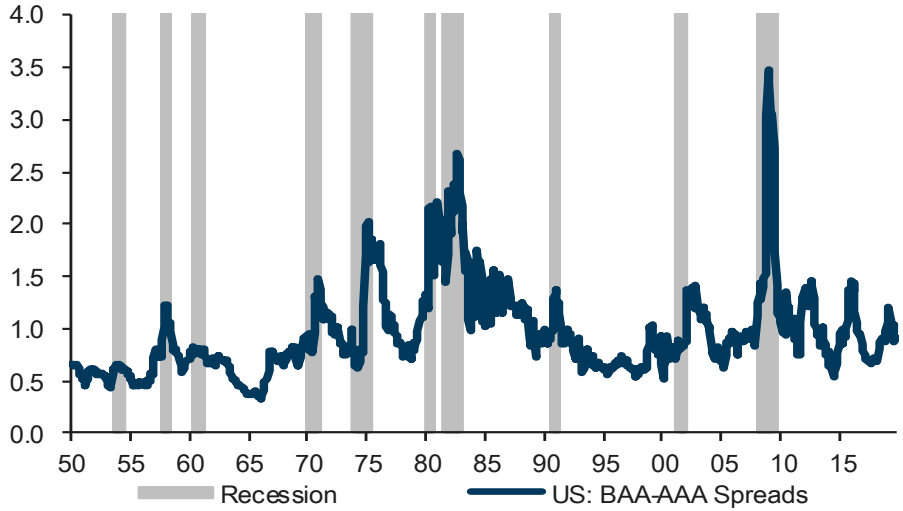
Source: Fed, NBER

US credit spreads are close to cyclical lows…



Source: Bloomberg, BEA, NBER

…and they typically spike before a recession

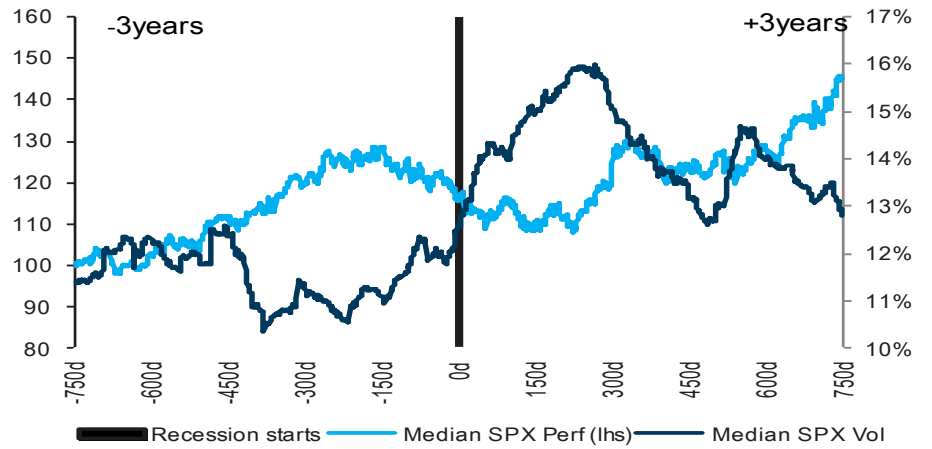


Source: Barclays Research

Equities could see significant downside in the case of a recession; fiscal cushion is limited

- S&P500 peaked on average 11 months after the yield curve inverted and 5 months before a recession started.
- Given the recent inversion of the 10-2Y curve, the equity bull market could still run into 2020. However, while stocks typically continue to rise for some time after the curve inverts, they generally produce lower risk-adjusted returns. US equities fell sharply during recessions, by 29% on average.
- In the case of a recession, fiscal cushion would be limited given the that the US are running a 5% deficit already.

S&P500 performance and volatility around past recessions



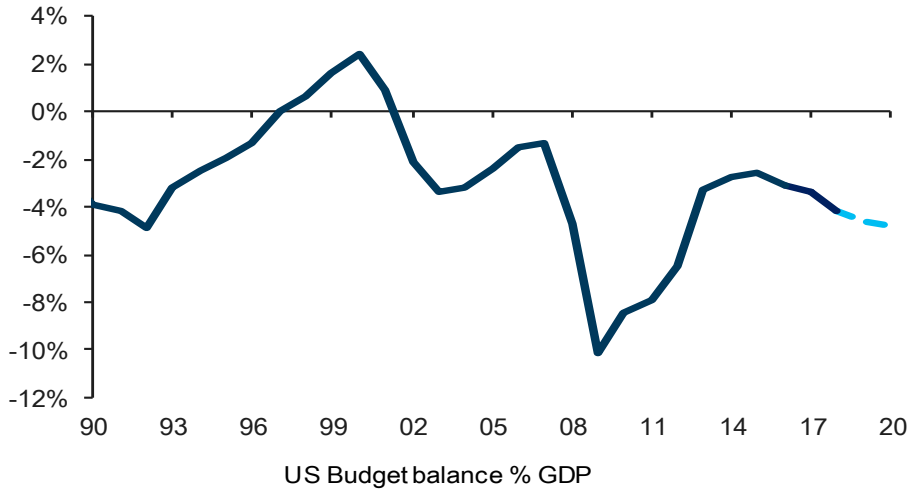
Source: Bloomberg

SPX performance during past recessions

Recession start	Recession end	SPX peak	SPX trough	SPX Peak-trough (months)	Perf: SPX peak to trough	Trailing EPS peak to trough
Jul-53	Apr-54	Jan-53	Sep-53	8	-11%	-18%
Aug-57	Mar-58	Jul-56	Dec-57	17	-17%	-22%
Apr-60	Jan-61	Jul-59	Oct-60	15	-10%	-12%
Dec-69	Oct-70	Nov-68	May-70	18	-36%	-13%
Nov-73	Feb-75	Oct-73	Oct-74	12	-44%	-15%
Jan-80	Jun-80	Jan-80	Mar-80	2	-15%	-5%
Jul-81	Oct-82	Nov-80	Aug-82	21	-27%	-19%
Jul-90	Feb-91	Jul-90	Oct-90	3	-20%	-37%
Mar-01	Oct-01	Aug-00	Oct-02	26	-49%	-54%
Dec-07	May-09	Oct-07	Mar-09	17	-57%	-92%
Average				**14**	**-29%**	**-29%**
Median				**16**	**-24%**	**-18%**

Source: Barclays Research

The US is running a large fiscal deficit already



Source: Barclays Economic Research, dotted line denotes Barclays forecast

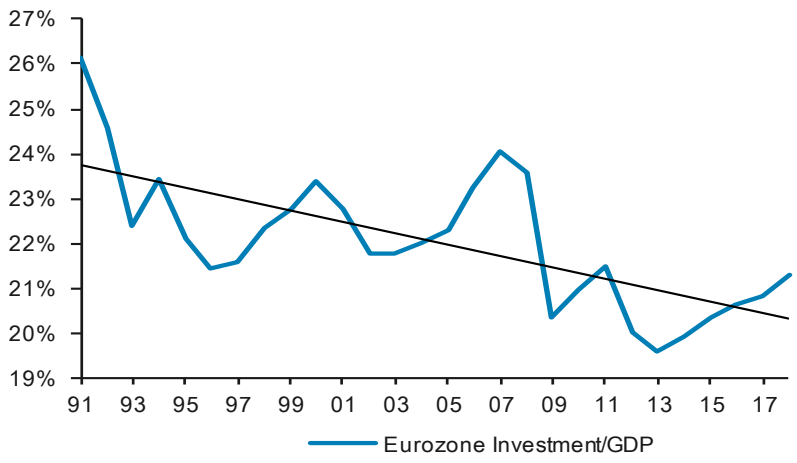
US activity heatmap

US HEAT MAP	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
Macro																					
ISM MFG	59.6	60.7	59.3	57.9	58.7	60.0	58.4	60.8	59.5	57.5	58.8	54.3	56.6	54.2	55.3	52.8	52.1	51.7	51.2	49.1	47.8
ISM MFG NEW ORDERS	65.2	64.3	62.4	61.7	62.9	63.0	60.8	64.5	61.5	58.0	61.8	51.3	58.2	55.5	57.4	51.7	52.7	50.0	50.8	47.2	47.3
ISM MFG NEW ORDER - INV	12.9	7.6	6.9	8.8	12.7	12.2	7.5	9.1	8.2	7.3	8.9	0.1	5.4	2.1	5.6	-1.2	1.8	0.9	1.3	-2.7	0.4
ISM NON MFG	59.4	59.1	58.7	57.2	58.9	58.7	56.7	58.8	60.8	60.0	60.4	58.0	56.7	59.7	56.1	55.5	56.9	55.1	53.7	56.4	
DODGE CONSTRUCTION	154	150	165	144	170	190	173	157	150	179	167	150	153	148	171	145	161	176	182	171	
OECD US INDUSTRIAL CONFIDENCE	101.3	101.3	101.2	101.1	101.2	101.3	101.3	101.4	101.3	101.1	100.9	100.6	100.5	100.3	100.2	100.0	99.8	99.7	99.5	99.2	
NFIB SMALL BIZ OPTIMISM	106.9	107.6	104.7	104.8	107.8	107.2	107.9	108.8	107.9	107.4	104.8	104.4	101.2	101.7	101.8	103.5	105.0	103.3	104.7	103.1	103.1
Inflation																					
CPI YOY	2.1	2.2	2.4	2.5	2.8	2.9	2.9	2.7	2.3	2.5	2.2	1.9	1.6	1.5	1.9	2.0	1.8	1.6	1.8	1.7	
CORE CPI YOY	1.7	1.7	2.0	2.0	2.1	2.0	2.1	2.0	2.0	1.9	2.0	2.0	1.8	1.6	1.5	1.6	1.5	1.6	1.7	1.8	
PPI YOY	0.4	0.0	0.3	-0.1	0.7	0.1	0.2	0.0	-0.1	0.8	-0.7	-0.5	-0.6	0.2	1.3	0.6	-0.3	-0.4	0.6	-0.6	
Employment																					
NFP	171	330	182	196	270	262	178	282	108	277	196	227	312	56	153	216	62	178	159	130	
ISM NON MFG EMPLOYMENT	60.5	55.1	56.3	55.0	55.2	54.4	56.6	56.8	60.4	58.3	58.0	56.6	57.8	55.2	55.9	53.7	58.1	55.0	56.2	53.1	
ISM MFG EMPLOYMENT	55.2	59.2	57.0	55.2	56.7	56.4	56.8	57.8	58.2	56.5	57.7	56.0	55.5	52.3	57.5	52.4	53.7	54.5	51.7	47.4	46.3
UNEMPLOYMENT	4.1	4.1	4.0	3.9	3.8	4.0	3.9	3.8	3.7	3.8	3.7	3.9	4.0	3.8	3.8	3.6	3.6	3.7	3.7	3.7	
AVG. HOURLY EARNINGS YOY	2.8	2.6	2.8	2.8	2.9	2.9	2.8	3.2	3	3.3	3.3	3.3	3.2	3.4	3.2	3.2	3.1	3.2	3.3	3.2	
Consumer																					
CONSUMER CONF	124.3	130.0	127.0	125.6	128.8	127.1	127.9	134.7	135.3	137.9	136.4	126.6	121.7	131.4	124.2	129.2	131.3	124.3	135.8	134.2	125.1
CONSUMER SENT	95.7	99.7	101.4	98.8	98.0	98.2	97.9	96.2	100.1	98.6	97.5	98.3	91.2	93.8	98.4	97.2	100.0	98.2	98.4	89.8	93.2
RETAIL SALES	4.3	4.8	4.9	4.7	6.5	6.1	6.5	6.1	3.9	4.8	4.0	1.4	2.6	1.9	3.8	3.8	3.0	3.3	3.6	4.1	
RETAIL SALES EX GAS & AUTOS	0.1	0.5	-0.1	0.4	1.3	0.0	0.6	0.0	-0.1	0.7	0.2	-2.2	2.8	-1.0	1.2	0.5	0.6	0.6	0.9	0.1	
Manufacturing & Industry																					
IP YOY	-0.3	0.4	0.6	0.9	-0.8	0.8	0.4	0.8	0.1	0.2	0.5	0.0	-0.4	-0.5	0.1	-0.6	0.2	0.1	-0.1	0.7	
CAP UTIL	77.6	77.8	78.2	78.8	78.1	78.6	78.8	79.3	79.3	79.3	79.6	79.5	79.0	78.5	78.4	77.8	77.8	77.8	77.5	77.9	
DURABLES GOODS EX TRANS	6.6	8.1	7.3	9.2	8.4	9.1	8.2	7.5	5.2	5.0	4.8	3.7	4.3	2.3	1.5	-0.1	0.2	0.4	-0.3	0.2	
CAPITAL GOODS EX AIRCRAFT & DEFENSE	1.1	-0.5	0.8	0.1	0.9	1	-0.2	0	0.7	-0.3	-0.1	1.2	0.3	-0.6	0.4	0.4	0	-0.6	0.4	0	
Housing																					
HOUSING STARTS	1,334	1,290	1,327	1,267	1,332	1,180	1,184	1,279	1,236	1,211	1,202	1,142	1,291	1,149	1,199	1,270	1,264	1,233	1,215	1,364	
NAHB HOUSEBUILDERS	72	71	70	68	70	68	68	67	67	68	60	56	58	62	62	63	66	64	65	67	68
HOUSE PRICES	6.2	6.5	6.5	6.4	6.3	6.2	6.0	5.7	5.5	5.3	5.0	4.6	4.2	3.9	3.7	3.6	3.5	3.3	3.2		

Source: Bloomberg, Barclays Research

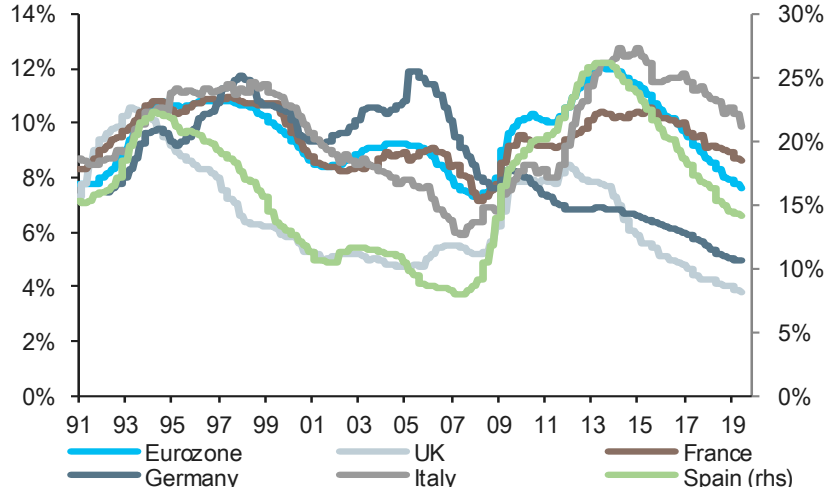
Eurozone: Private demand is holding-up…

Eurozone capex share of GDP has rebounded



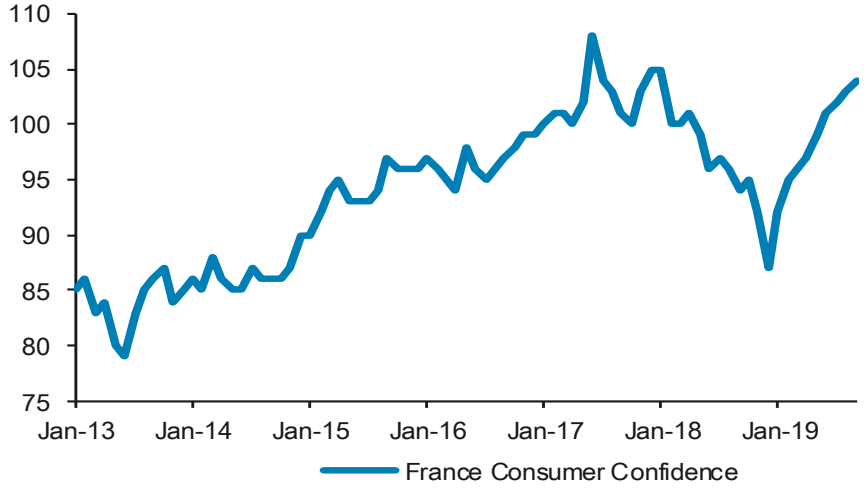
Source: IMF

Unemployment rate is at cycle lows across the Eurozone



Source: Eurostat

French consumer sentiment rebounded strongly ytd



Source: Bloomberg

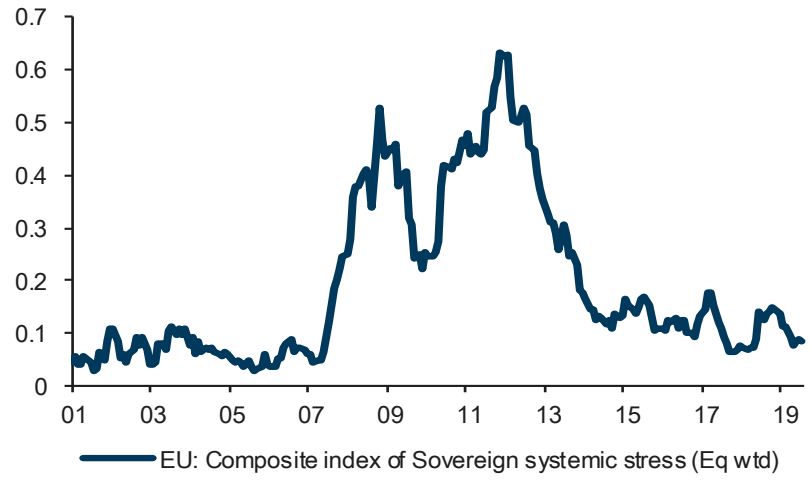
Bank lending to corporate is growing, but consumer credit is soft

Source: Barclays Economic Research

…as financing conditions are accommodative…

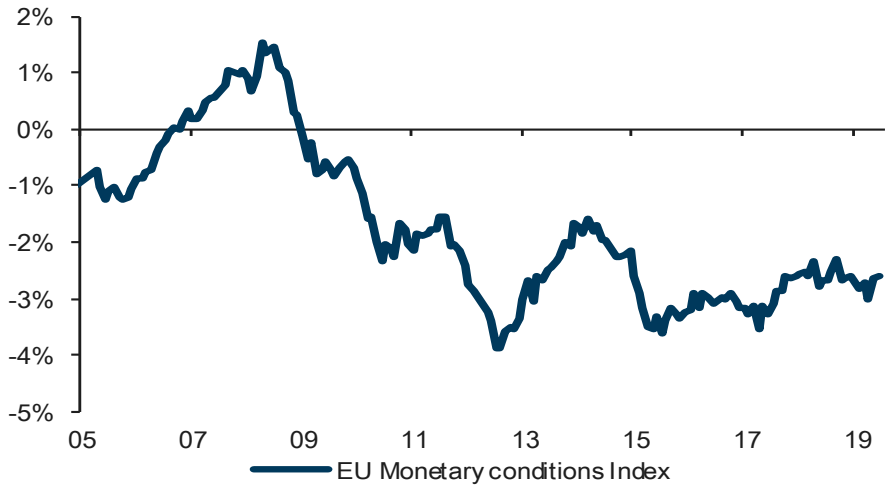
- Based on ECB indicators, sovereign systemic stress and country-level financial market stress are all subdued currently in Europe.
- The monetary conditions index (MCI), which is a measure based on REER and short-term rates, also suggests a benign credit environment.
- However, bank lending growth remains soft across the Eurozone.

The ECB's measure of systemic stress is low



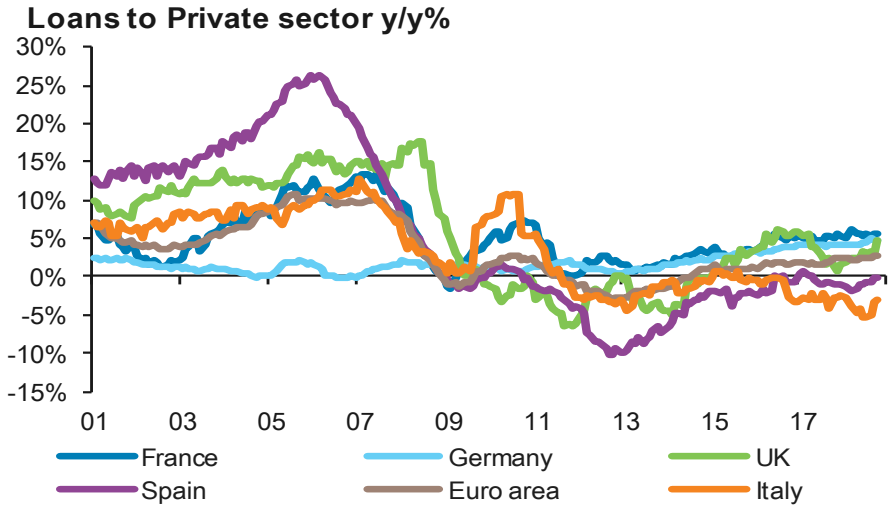
Source: Haver, ECB

Monetary conditions are still loose...



Source: Haver, Eurostat

...but credit growth is lacklustre

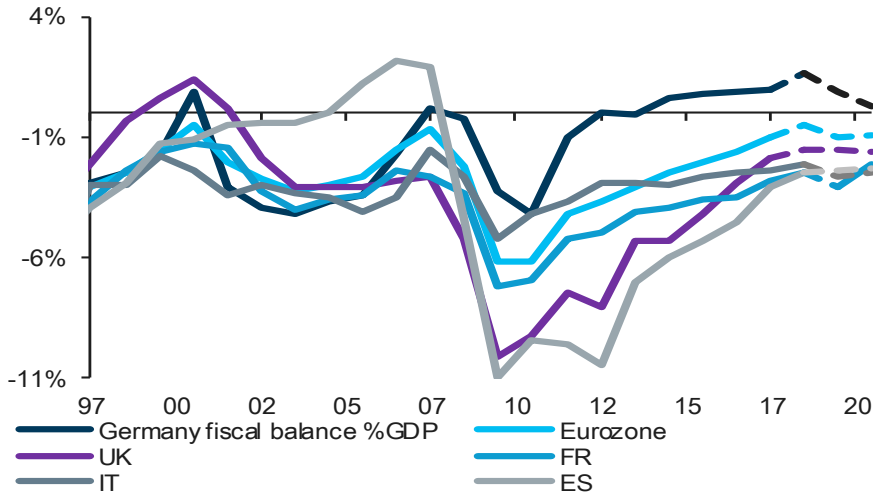


Source: ECB, BOE, Banque France, Bundesbank, Bank of Italy, Banco de Espana, Datastream, Bloomberg

…and fiscal policy is turning less restrictive

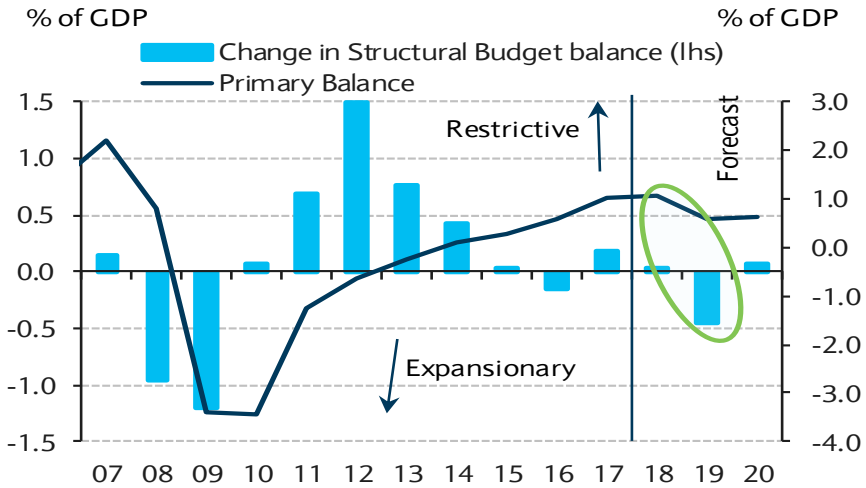
- In 2019 Germany, France and Italy are set to deliver their most accommodative fiscal policies of the past decade. Germany is expected to loosen the most (0.8% of GDP), lending support to improved GDP growth.
- Germany and Italy's fiscal efforts are mainly skewed towards primary expenditures, with increased social payments and investment in the former, and the deployment of the universal income in the latter.
- In France, despite the €10bn boost in expenditure announced in December, we calculate that the driving force of the fiscal package is on the revenue side.

Fiscal policy is loosening across the Eurozone



Source: Barclays Economic Research

Change in Eurozone structural budget balance suggests most accommodative stance since 2009



Source: Haver Analytics, Barclays Research

The Big 3 fiscal plans in short

	Germany	France	Italy
Consumers	*0.6% of GDP	*0.6% of GDP: President Macron 10 Dec measures (0.4% of GDP) + 0.2% (2019 budget: tax cuts measures)	* 0.4% of GDP (universal income)
Companies	-	* 0.8% of GDP (mainly permanent cut in social charges)	* 0.1% of GDP (flat tax)

Source: Barclays Economic Research

The delta in growth comes from external demand, though

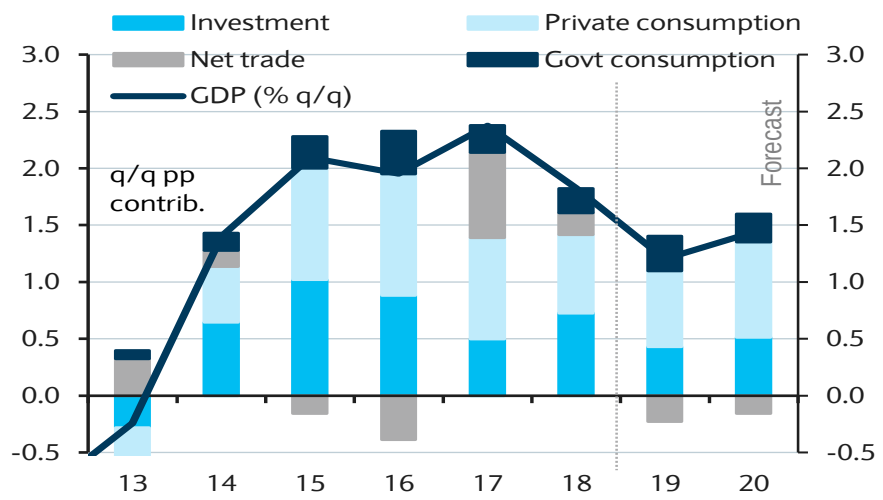
- The weaker growth in Eurozone is mostly due to weaker external demand.
- Our economists expect net trade to turn into a drag on Eurozone growth in 2019, but forecast domestic demand to stay resilient.
- Services and manufacturing PMIs have diverged ytd but the gap is starting to narrow.

Eurozone countries macro snapshot

	GDP y/y		Unemployment Rate		Fiscal Balance %GDP		Public Debt %GDP		Current account %GDP	
	18	19e	18	19e	18	19e	18	19e	18	19e
Eurozone	1.9	1.2	8.2	7.5	-0.5	-0.9	87.1	86.5	3.3	2.5
France	1.7	1.3	9.1	8.4	-2.5	-3.1	98.4	98.9	-0.7	-0.5
Germany	1.5	0.5	3.4	3.2	1.7	0.8	60.9	58.7	7.5	7.4
Italy	0.7	0.0	10.6	10.0	-2.1	-2.1	132.2	133.6	2.5	2.7
Spain	2.6	2.2	23.9	14	-2.5	-2.3	97.1	96.7	1.1	0.9
UK	1.4	1.2	4.0	4.3	-1.1	-1.5	83.0	83.5	-3.9	-3.3

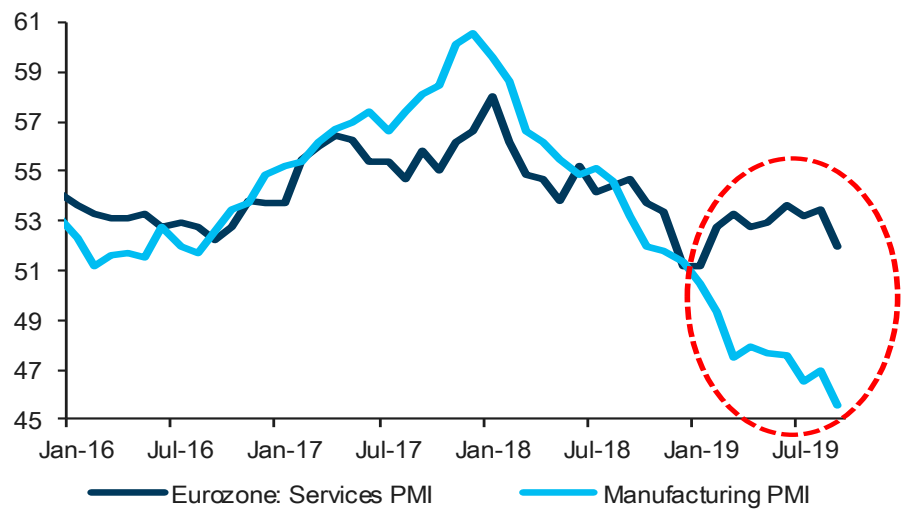
Source: Barclays Economics Research

External demand remains a drag on Eurozone growth



Source: Barclays Economics Research

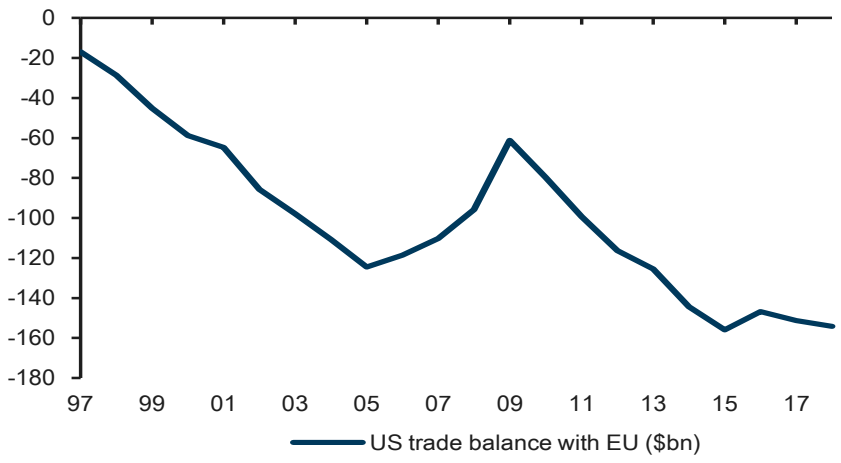
Eurozone Services and Manufacturing PMIs are diverging



Source: Barclays Research, Bloomberg, Markit

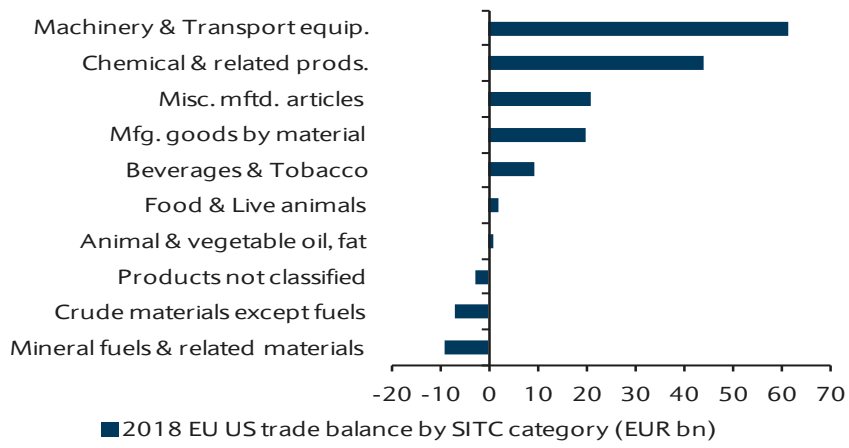
US tariffs on European cars are a significant threat

US trade deficit with the EU has increased materially



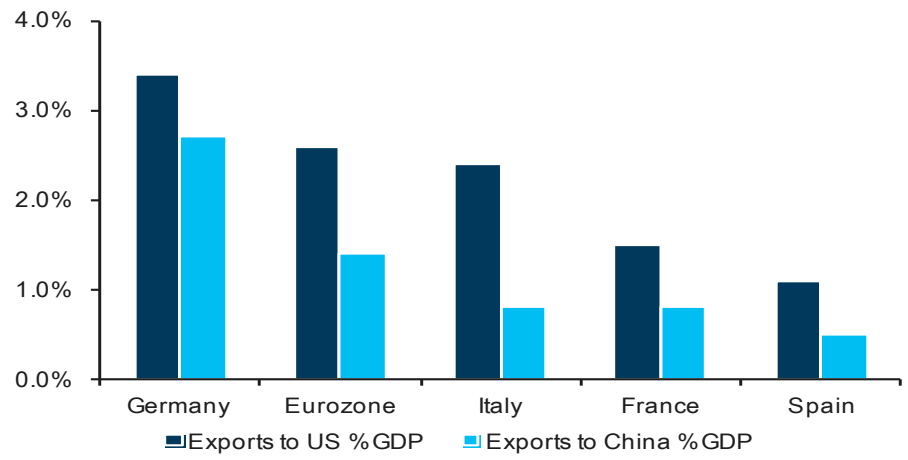
Source: Census

2018 EU-US trade balance by SITC category



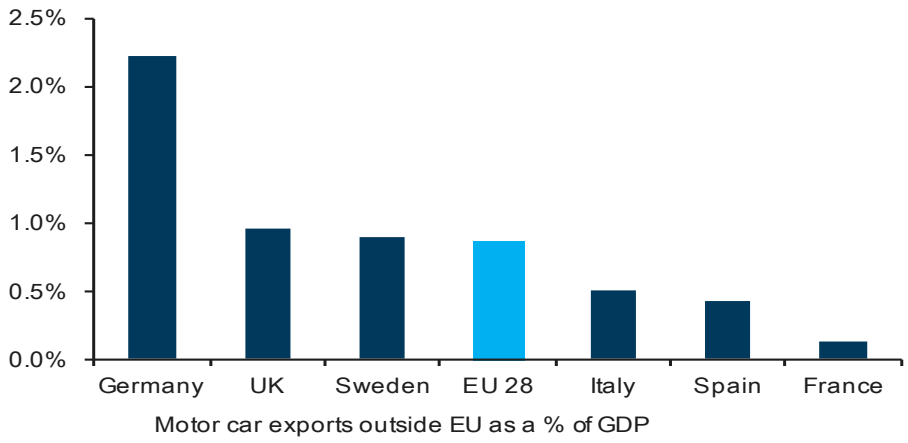
Source: Census, EUR bn

Germany is the most exposed to US and China trade



Source: Eurostat

Car exports matter for German GDP



Source: Eurostat

Eurozone activity heatmap

	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
Eurozone																					
Macro																					
Composite PMI	58.8	57.1	55.2	55.1	54.1	54.9	54.3	54.5	54.1	53.1	52.7	51.1	51	51.9	51.6	51.5	51.8	52.2	51.5	51.9	50.4
Mfg PMI	59.6	58.6	56.6	56.2	55.5	54.9	55.1	54.6	53.2	52	51.8	51.4	50.5	49.3	47.5	47.9	47.7	47.6	46.5	47	45.6
Services PMI	58	56.2	54.9	54.7	53.8	55.2	54.2	54.4	54.7	53.7	53.4	51.2	51.2	52.8	53.3	52.8	52.9	53.6	53.2	53.5	52
Construction PMI	57	53.9	50.6	52.5	52.7	51.9	50.3	51	51.6	52.2	53	53.1	50.6	52.6	52.2	52.1	50.6	50.8	50.6	49.1	49.1
EU manufacturing confidence	10.2	9.1	7.3	8.2	7.5	7.7	6.2	6.1	5.5	4.2	4.4	2.3	0.6	-0.4	-1.6	-4.3	-2.9	-5.6	-7.3	-5.8	-8.8
EU services confidence	16.2	17.5	16.6	15.4	14.9	15.1	15.8	14.8	15.2	14	14	12.2	11	12.1	11.5	11.8	12.1	11	10.6	9.2	9.5
IP ex const. y/y%	3.7	2.4	3	1.6	2.7	2.4	0	0.9	0.6	1.1	-2.9	-4.2	-0.6	-0.2	-0.8	-0.7	-0.8	-2.4	-2	-2	-2
Inflation																					
Headline CPI y/y%	1.3%	1.1%	1.4%	1.2%	2.0%	2.0%	2.2%	2.1%	2.1%	2.3%	1.9%	1.5%	1.4%	1.5%	1.4%	1.7%	1.2%	1.30%	1.00%	1.00%	
Core CPI y/y%	1.0%	1.0%	1.1%	0.7%	1.2%	1.0%	1.1%	1.0%	1.0%	1.2%	0.9%	0.9%	1.1%	1.0%	0.8%	1.3%	0.8%	1.10%	0.90%	0.90%	
Consumer																					
EU consumer confidence	-3.2	-3.5	-4.2	-4.4	-4.8	-4.8	-4.7	-4.9	-5.6	-5.3	-6.1	-7.8	-7.4	-6.9	-6.6	-7.3	-6.5	-7.2	-6.6	-7.1	-6.5
Retail sales ex autos y/y%	2.7%	2.2%	2.3%	3.0%	2.8%	2.9%	2.1%	3.1%	1.2%	4.3%	2.1%	1.1%	2.5%	3.5%	2.5%	2.7%	2.0%	3.1%	3.1%		
Car sales y/y%	7.1%	4.3%	-5.3%	9.6%	0.8%	10.5%	10.5%	31.2%	-23.5%	-7.3%	-8.0%	-8.4%	-4.6%	-1.0%	-3.9%	-0.4%	0.1%	1.4%	1.4%	-8.4%	
Lending																					
Money supply M1, y/y%	8.8%	8.4%	7.5%	7.1%	7.5%	7.4%	7.0%	6.5%	6.9%	6.8%	6.7%	6.6%	6.2%	6.6%	7.5%	7.4%	7.2%	7.2%	7.8%	8.4%	
Loans to Non Fin corps. y/y%	2.4%	2.2%	2.4%	2.5%	2.9%	2.7%	3.1%	3.2%	3.3%	2.9%	3.1%	2.9%	2.3%	2.6%	2.5%	2.8%	2.7%	3.3%	3.3%	3.5%	
Loans to Households y/y%	3.1%	2.9%	3.0%	2.9%	3.0%	3.0%	3.3%	3.1%	3.1%	3.2%	3.2%	3.0%	3.2%	3.2%	3.1%	3.2%	3.1%	3.2%	3.2%	3.2%	
Country snapshot																					
Germany																					
Composite PMI	59	57.6	55.1	54.6	53.4	54.8	55	55.6	55	53.4	52.3	51.6	52.1	52.8	51.4	52.2	52.6	52.6	50.9	51.7	49.1
Mfg PMI	61.1	60.6	58.2	58.1	56.9	55.9	56.9	55.9	53.7	52.2	51.8	51.5	49.7	47.6	44.1	44.4	44.3	45	43.2	43.5	41.4
Services PMI	57.3	55.3	53.9	53	52.1	54.5	54.1	55	55.9	54.7	53.3	51.8	53	55.3	55.4	55.7	55.4	55.8	54.5	54.8	52.5
Construction PMI	59.8	52.7	47	50.9	53.9	53	50	51.5	50.2	49.8	51.3	53.3	50.7	54.7	55.6	53	51.4	50	49.5	46.3	46.3
Consumer Confidence	2.8	3.1	2.2	1.3	0.9	0.4	-0.6	0.7	1.2	0.9	0.8	-0.4	-0.4	-0.2	-0.1	-0.7	-1.4	-3.1	-2.9	-3.9	-2.4
France																					
Composite PMI	59.6	57.3	56.3	56.9	54.2	55	54.4	54.9	54	54.1	54.2	48.7	48.2	50.4	48.9	50.1	51.2	52.7	51.9	52.9	51.3
Mfg PMI	58.4	55.9	53.7	53.8	54.4	52.5	53.3	53.5	52.5	51.2	50.8	49.7	51.2	51.5	49.7	50	50.6	51.9	49.7	51.1	50.3
Services PMI	59.2	57.4	56.9	57.4	54.3	55.9	54.9	55.4	54.8	55.3	55.1	49	47.8	50.2	49.1	50.5	51.5	52.9	52.6	53.4	51.6
Consumer Confidence	-4.7	-6.8	-6.3	-7.5	-8.1	-9.7	-8.8	-9.6	-12.6	-10.9	-13.9	-17.5	-13.8	-11.6	-10.8	-11.1	-9.5	-9.3	-7.3	-7.7	-5.6
Italy																					
Composite PMI	59	56	53.5	52.9	52.9	53.9	53	51.7	52.4	49.3	49.3	50	48.8	49.6	51.5	49.5	49.9	50.1	51	50.3	50.3
Mfg PMI	59	56.8	55.1	53.5	52.7	53.3	51.5	50.1	50	49.2	48.6	49.2	47.8	47.7	47.4	49.1	49.7	48.4	48.5	48.7	48.7
Services PMI	57.7	55	52.6	52.6	53.1	54.3	54	52.6	53.3	49.2	50.3	50.5	49.7	50.4	53.1	50.4	50	50.5	51.7	50.6	50.6
Consumer Confidence	-11.1	-11.1	-11.3	-10.5	-12.0	-9.4	-8.8	-9.5	-9.9	-9.5	-10.7	-10.2	-10.5	-11.8	-13.1	-13.4	-12.1	-14.0	-11.8	-12.9	-13.8
Spain																					
Composite PMI	56.7	57.1	55.8	55.4	55.9	54.8	52.7	53	52.5	53.7	53.9	53.4	54.5	53.5	55.4	52.9	52.1	52.1	51.7	52.6	52.6
Mfg PMI	55.2	56	54.8	54.4	53.4	53.4	52.9	53	51.4	51.8	52.6	51.1	52.4	49.9	50.9	51.8	50.1	47.9	48.2	48.8	48.8
Services PMI	56.9	57.3	56.2	55.6	56.4	55.4	52.6	52.7	52.5	54	54	54	54.7	54.5	56.8	53.1	52.8	53.6	52.9	54.3	54.3
Consumer Confidence	-2.8	-2.9	-5.9	-4.9	-3.2	-0.8	-1.4	-3.3	-6.4	-6.5	-4.9	-7.2	-6.9	-5.4	-2.0	-6.1	-3.7	-2.1	-4.9	-6.2	-6.2

Source: Datastream, Bloomberg, Barclays Research

China: Money supply is not rebounding much (2019 is not 2016)…

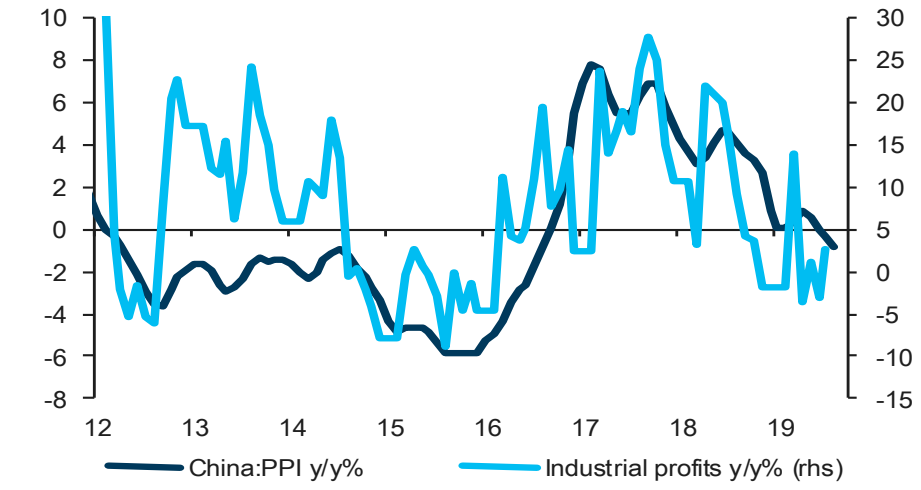
China money supply leads manufacturing confidence – this is not 2016

Source: Bloomberg, Barclays Research

House price inflation is still positive

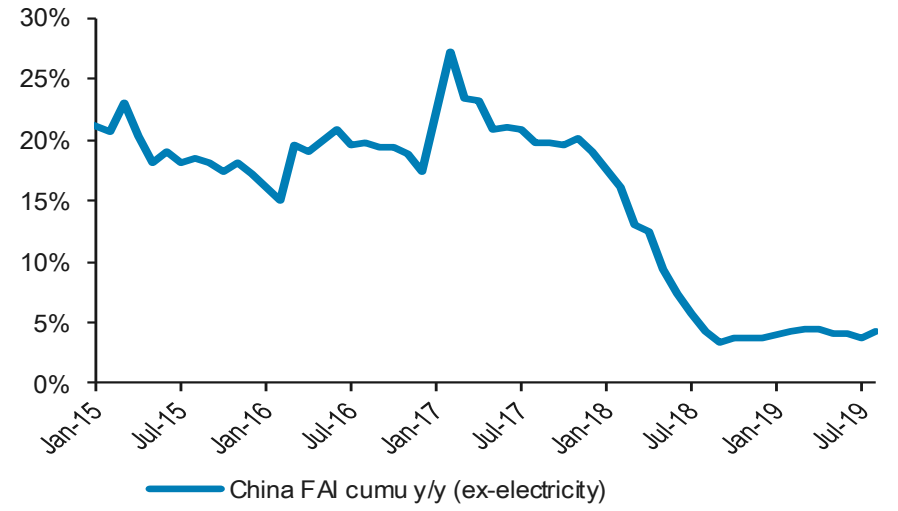
Source: Bloomberg

Weak PPI is a headwind for corporate earnings



Source: NBS, Bloomberg

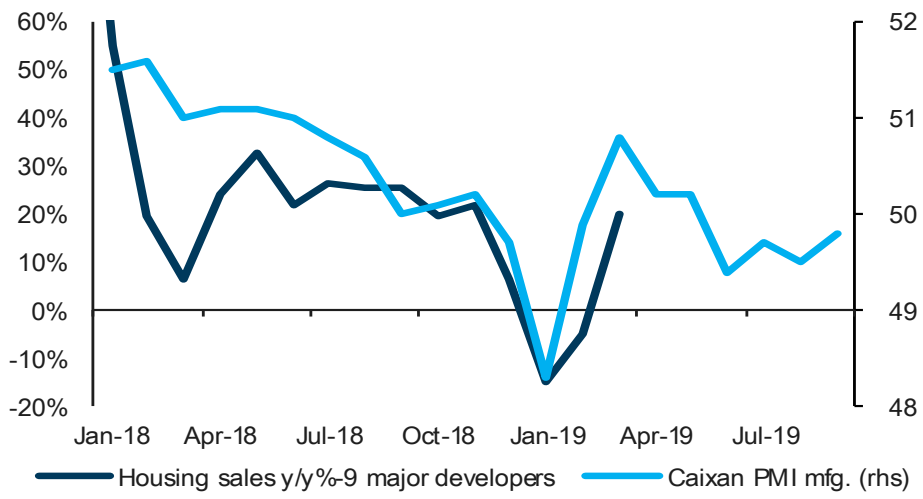
FAI is stabilising…at a low level



Source: Bloomberg

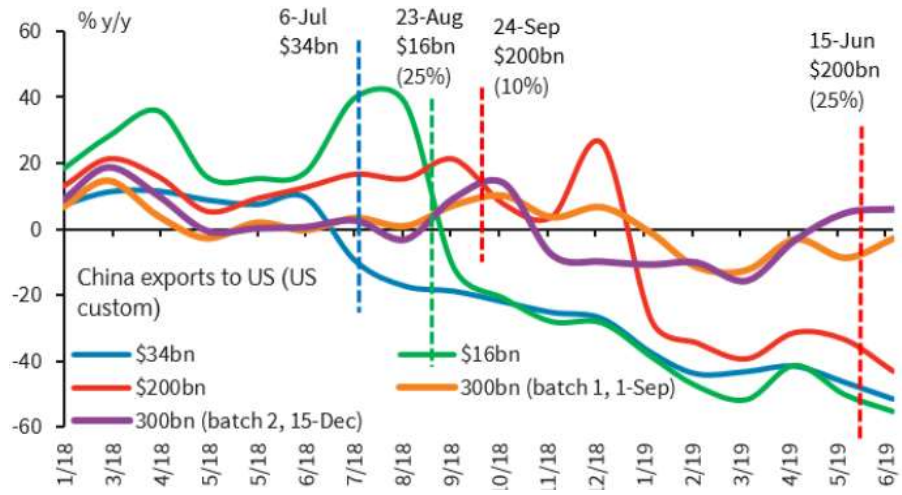
…car sales, exports and manufacturing are under pressure

PMIs stabilised recently after rolling over in Q2



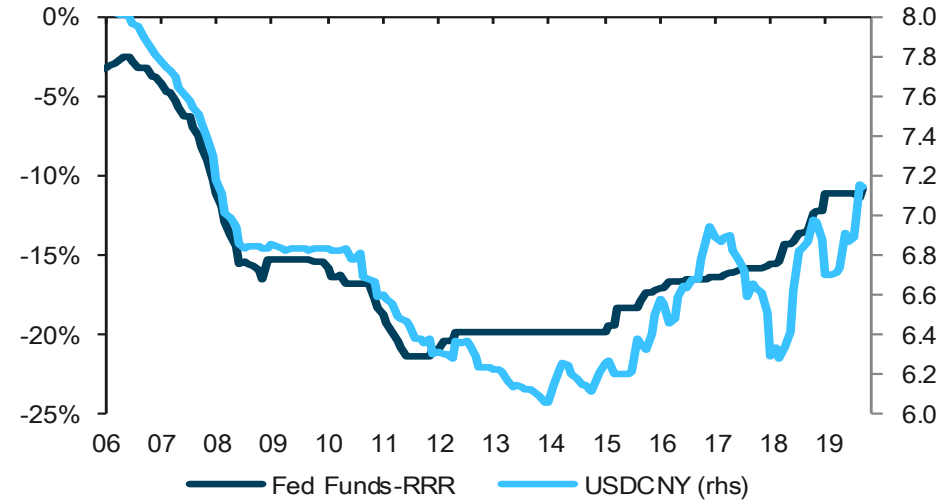
Source: Bloomberg

Tariff impact on China exports to US is negative



Source: USITC, USTR, Barclays Research

CNY is weakening again



Source: Bloomberg

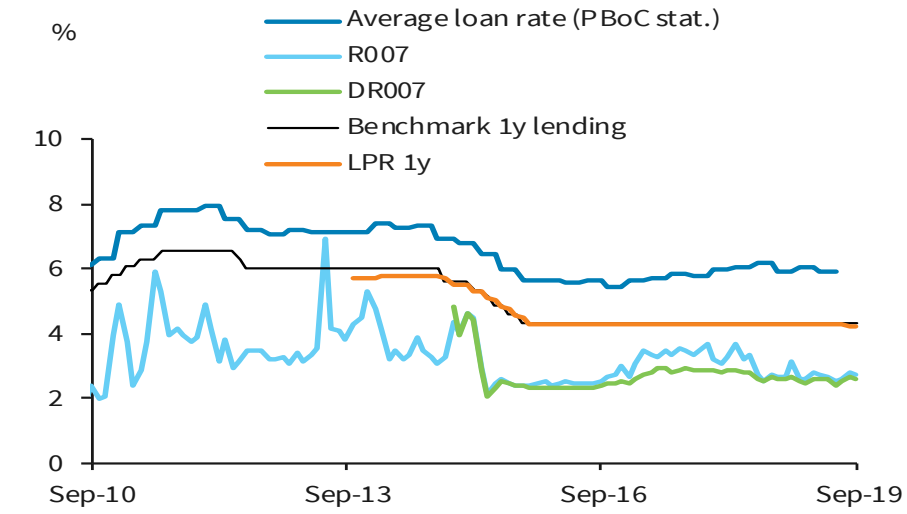
Car sales keep falling

Source: Datastream

Lower growth and less easing is likely becoming the new norm

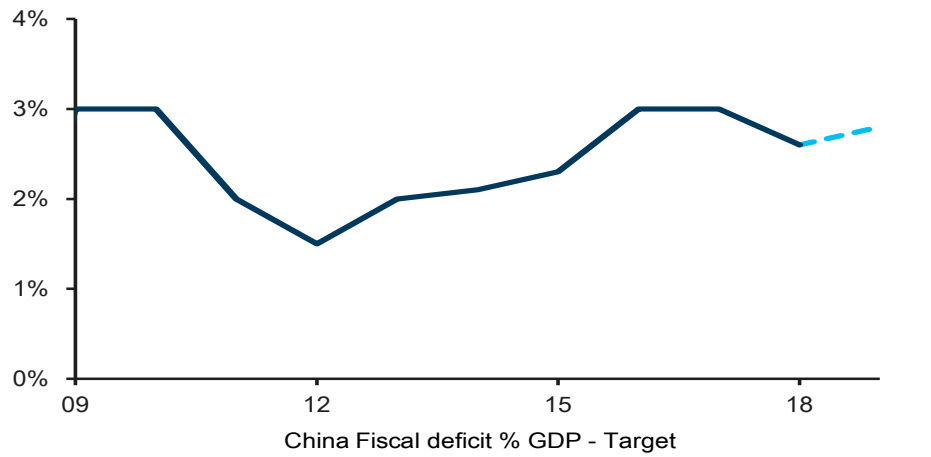
- Our economists think the PBoC will continue to balance growth objectives against high leverage, the risk of a housing bubble and financial stability concerns.
- In contrast to other central banks' preemptive easing, the PBoC has been reactive, in our view. As further evidence of a slowdown materializes, we expect the PBoC to guide interest rates lower. We believe it will use a variety of tools including targeted RRR cuts, following the Fed in lowering policy rates.

PBoC likely to guide interest rates lower



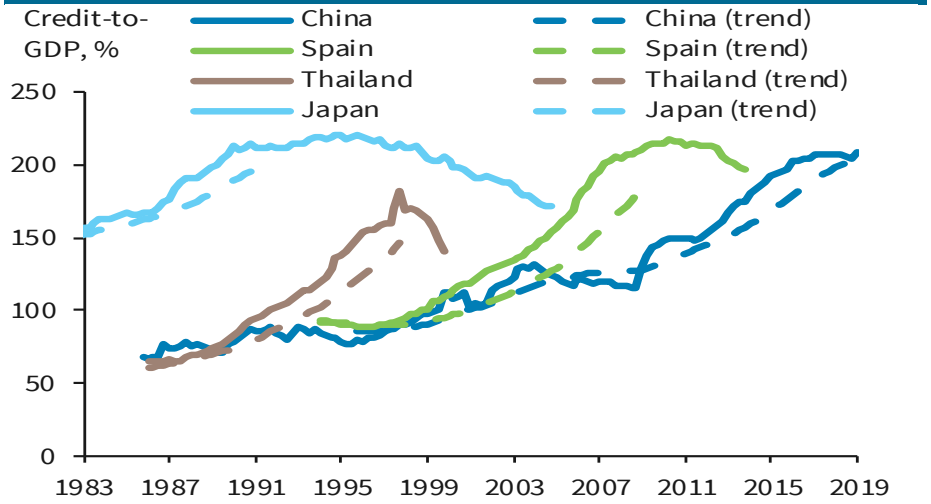
Source: Barclays Economics Research

China fiscal deficit is on the rise



Source: Barclays Economics Research

China's credit/GDP is elevated



Source: BIS, Barclays Economics Research, Note: the gap is defined as debt/GDP - trend

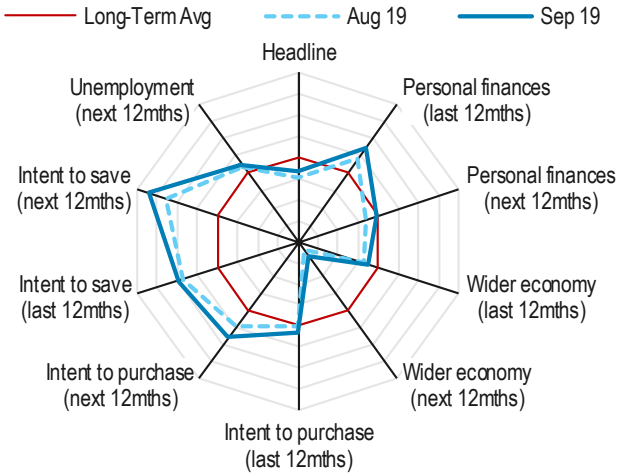
China activity heat map

	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
PMI mfg																					
Caixan	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	50.0	50.1	50.2	49.7	48.3	49.9	50.8	50.2	50.2	49.4	49.9	50.4	51.4
NBS	51.3	50.3	51.5	51.4	51.9	51.5	51.2	51.3	50.8	50.2	50.0	49.4	49.5	49.2	50.5	50.1	49.4	49.4	49.7	49.5	49.8
PMI Services																					
Caixan	54.7	54.2	52.3	52.9	52.9	53.9	52.8	51.5	53.1	50.8	53.8	53.9	53.6	51.1	54.4	54.5	52.7	52.0	51.6	52.1	52.1
NBS	55.3	54.4	54.6	54.8	54.9	55.0	54.0	54.2	54.9	53.9	53.4	53.8	54.7	54.3	54.8	54.3	54.3	54.2	53.7	53.8	53.7
PMI Composite																					
Caixan	53.7	53.3	51.8	52.3	52.3	53.0	52.3	52.0	52.1	50.5	51.9	52.2	50.9	50.7	52.9	52.7	51.5	50.6	50.9	51.6	51.6
Industry																					
FAI, y/y%	7.2%	7.9%	7.5%	7.0%	6.1%	6.0%	5.5%	5.3%	5.4%	5.7%	5.9%	5.9%	5.9%	6.1%	6.3%	6.1%	5.6%	5.8%	5.7%	5.5%	
IP, y/y%		7.2%	6.0%	7.0%	6.8%	6.0%	6.0%	6.1%	5.8%	5.9%	5.4%	5.7%	5.3%	5.3%	8.5%	5.4%	5.0%	6.3%	4.8%	4.4%	
Rail freight, y/y%	7.6%	0.7%	2.3%	1.5%	10.9%	10.2%	9.6%	7.1%	8.9%	7.9%	8.7%	7.1%	6.2%	-1.6%	0.7%	9.1%	4.9%	2.6%	4.2%	3.2%	
Electricity consumtion y/y%	12.8%	12.8%	4.3%	7.6%	11.7%	8.0%	6.8%	8.8%	8.4%	7.0%	6.3%	8.8%	4.8%	4.8%	7.6%	6.1%	2.3%	5.7%	2.9%	3.8%	
Excavator sales (Thous,12m ma)	12.2	11.9	13.3	14.3	15.0	15.4	15.7	16.0	16.2	16.6	16.8	17.0	17.0	17.7	18.2	18.3	18.3	18.7	19.3	19.9	20.4
Steel PMI	48.0	34.1	64.9	58.3	51.0	46.6	46.6	49.8	56.5	55.8	48.6	45.4	48.8	35.3	61.8	59.0	51.1	46.5	48.3	50.9	52.9
Li Keqiang index	11.2	9.7	6.4	8.2	11.2	9.8	9.5	9.6	8.9	8.8	8.4	9.3	7.8	6.2	7.8	8.7	6.4	6.9	6.1	6.3	
Housing & Real estate																					
70 city house price index, y/y%	5.4%	5.8%	5.5%	5.3%	5.4%	5.8%	6.6%	8.0%	8.9%	9.7%	10.3%	10.6%	10.8%	11.1%	11.3%	11.4%	11.3%	10.8%	10.1%	9.1%	
100 city house price index, y/y%	7.0%	6.9%	6.3%	5.9%	5.7%	5.6%	5.4%	5.3%	5.3%	5.4%	5.2%	5.1%	4.9%	4.6%	4.4%	4.3%	4.0%	3.9%	3.8%	3.7%	
Residential Floor space started	15.1%	6.4%	12.9%	10.0%	16.4%	16.3%	27.0%	29.3%	28.3%	21.1%	18.2%	20.1%	23.0%	13.9%	11.7%	13.9%	14.2%	10.5%	6.1%	5.9%	
Residential Floor space sold	4.0%	3.3%	2.5%	0.1%	2.2%	3.2%	8.4%	6.5%	4.2%	0.1%	-2.0%	-0.7%	-0.4%	-0.2%	-0.7%	0.5%	0.3%	-1.0%	-0.9%	3.1%	
Consumer																					
Auto sales	11.5%	-11.4%	4.5%	11.3%	9.1%	4.7%	-4.2%	-3.8%	-11.6%	-12.0%	-13.9%	-13.0%	-15.7%	-13.7%	-5.1%	-14.6%	-16.4%	-9.6%	-4.3%	-6.9%	
Retail sales		9.7%	10.1%	9.4%	8.5%	9.0%	8.8%	9.0%	9.2%	8.6%	8.1%	8.2%		8.2%	8.7%	7.2%	8.6%	9.8%	7.6%	7.5%	
Monetary conditions																					
Real M1 y/y%	13.5%	5.6%	5.0%	5.4%	4.2%	4.7%	3.0%	1.6%	1.5%	0.2%	-0.7%	-0.4%	-1.3%	0.5%	2.3%	0.4%	0.7%	1.7%	0.3%	0.6%	
Lending growth y/y%	13.2%	12.8%	12.8%	12.7%	12.6%	12.7%	13.2%	13.2%	13.2%	13.1%	13.1%	13.5%	13.4%	13.4%	13.7%	13.5%	13.4%	13.0%	12.6%	12.4%	
FX reserves ($bn)	3,161	3,134	3,143	3,125	3,111	3,112	3,118	3,110	3,087	3,053	3,062	3,073	3,088	3,090	3,099	3,095	3,101	3,119	3,104	3,107	
New loan creation (CNY bn)	2,893	839	1,117	1,177	1,152	1,842	1,453	1,275	1,384	697	1,249	1,084	3,230	886	1,690	1,020	1,180	1,664	1,060	1,210	

Source: Datastream, Bloomberg

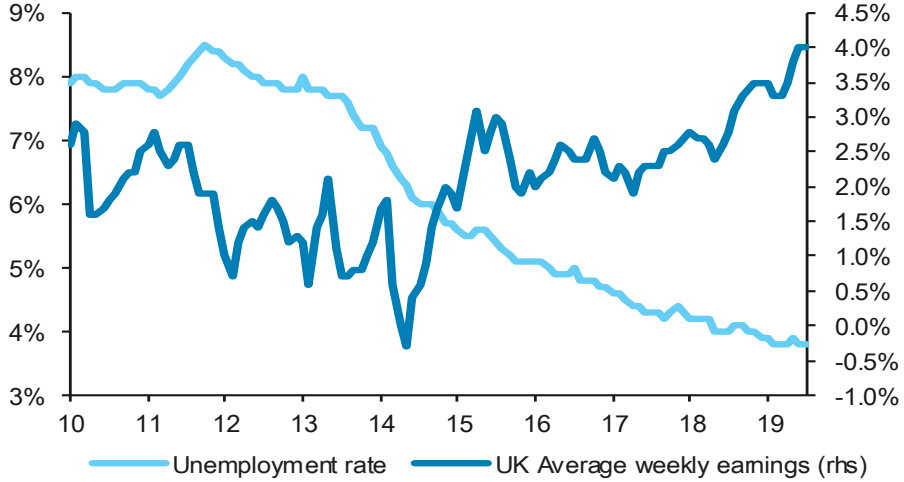
UK: Consumer is holding up…

Consumer confidence ticked up in September for most measures, although economic confidence remains low



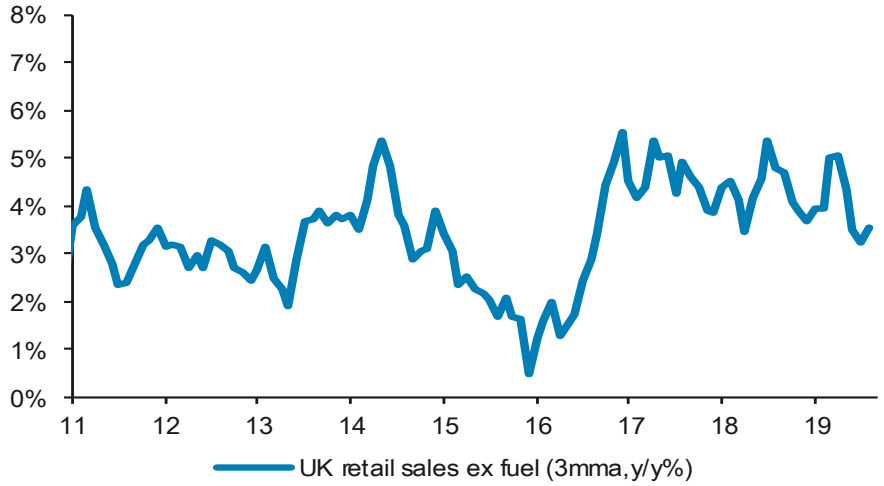
Source: Barclays Economics Research

The labour market has been resilient, so far



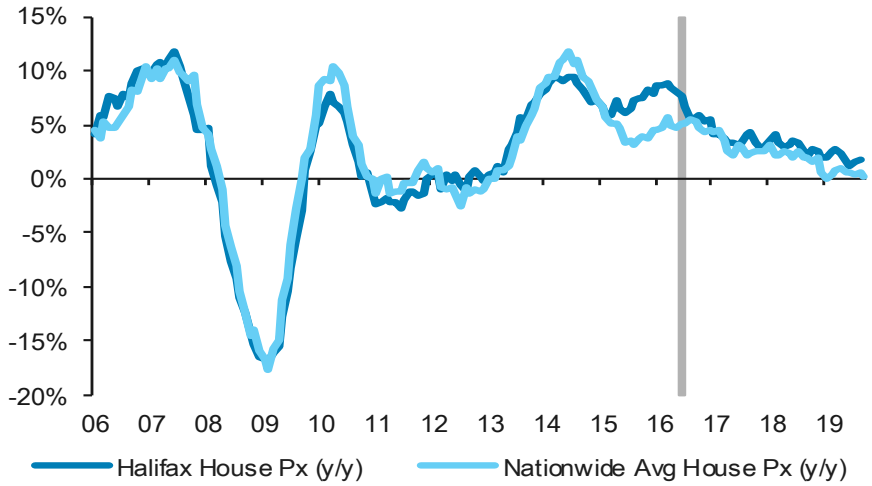
Source: Datastream, Barclays Research

UK retail sales were lower over the summer on tough comp from sunny 2018, but ticked up slightly in August



Source: Bloomberg

The housing market has been slowing since 2016



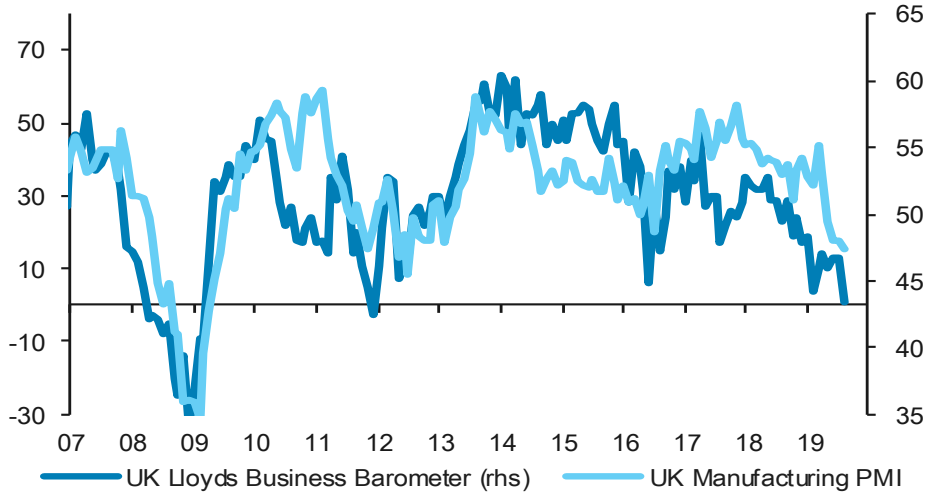
Source: Worldscope, Barclays Research

…but Corporates are turning increasingly cautious

UK PMIs on employment and inventories are stable after sharply declining in Q2

Source: Barclays Economics Research

Business confidence moved lower again in August

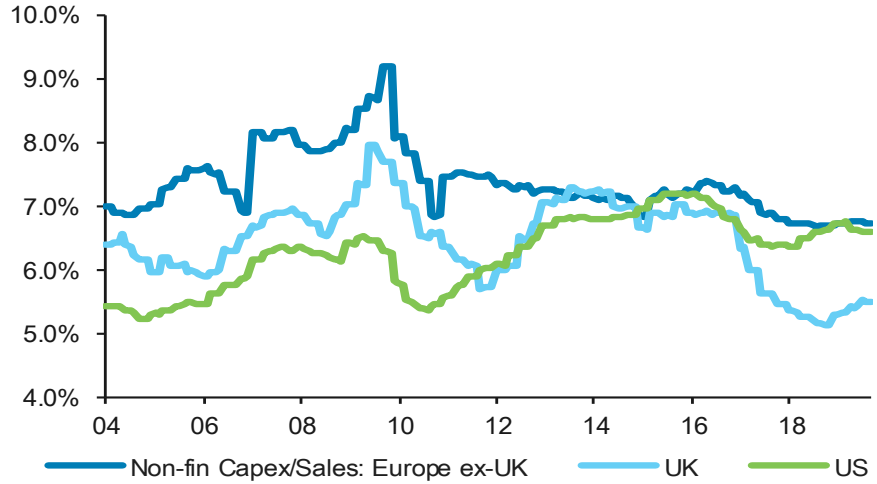


Source: Datastream, Barclays Research, Lloyds, Markit.

Services: Costs per employee are increasing moderately

Source: Bloomberg

UK capex to sales has fallen much more than for Europe, although it has crept up ytd



Source: Worldscope, Barclays Research

UK activity heat map

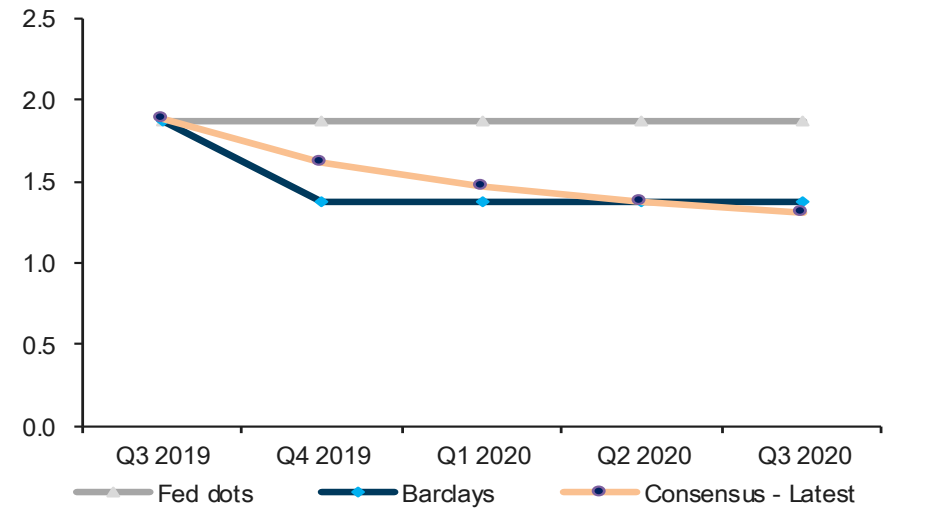
	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19
Macro																					
Composite PMI	53.4	54.5	52.4	53.2	54.4	55.1	53.5	54.2	54.1	52.1	50.8	51.4	50.3	51.5	50	50.9	50.9	49.7	50.7	50.2	
Mfg PMI	55.2	55.3	54.8	53.8	54.3	54	53.9	52.9	53.7	51.1	53.3	54.3	52.8	52.1	55.1	53.1	49.4	48	48	47.4	
Services PMI	53	54.5	51.7	52.8	54	55.1	53.5	54.3	53.9	52.2	50.4	51.2	50.1	51.3	48.9	50.4	51	50.2	51.4	50.6	
Construction PMI	50.2	51.4	47	52.5	52.5	53.1	55.8	52.9	52.1	53.2	53.4	52.8	50.6	49.5	49.7	50.5	48.6	43.1	45.3	45	
Industrial confidence	12.3	6.7	-1.4	4.2	3.8	7.4	8	9.1	5.2	-3.0	3.8	8.1	3.4	0.9	-1.4	-5.9	-11.1	-8.7	-16.2	-9.7	-25.3
Lloyds business confidence	35	33	32	32	35	29	29	23	29	19	24	17	19	4	10	14	10	13	13	1	2
Inflation																					
CPI	3.0%	2.7%	2.5%	2.4%	2.4%	2.4%	2.5%	2.7%	2.4%	2.4%	2.3%	2.1%	1.8%	1.9%	1.9%	2.1%	2.0%	2.0%	2.1%	1.7%	
Halifax House Px y/y%	3.5%	4.2%	3.3%	3.0%	3.2%	3.5%	3.3%	2.6%	2.0%	2.7%	2.5%	2.0%	1.9%	2.5%	2.8%	2.4%	1.6%	1.2%	1.5%	1.8%	
Nationwide House Px y/y%	3.2%	2.2%	2.1%	2.6%	2.4%	2.0%	2.5%	2.0%	2.0%	1.6%	1.9%	0.5%	0.1%	0.4%	0.7%	0.9%	0.6%	0.5%	0.3%	0.6%	0.2%
Labour																					
Unemployment	4.3%	4.2%	4.2%	4.2%	4.2%	4.0%	4.0%	4.0%	4.1%	4.1%	4.0%	4.0%	3.9%	3.9%	3.8%	3.8%	3.8%	3.9%	3.8%		
REC Wage survey	62.3	61.5	60	60.5	63.4	61.8	60.2	62.4	64.5	64.3	63.2	62.6	63.4	61.5	59.3	59.2	58.9	59.1	58.8	55.5	
Avg Wkly Earnings y/y%, whole econ (3ma)	2.7%	2.8%	2.7%	2.7%	2.6%	2.4%	2.6%	2.8%	3.1%	3.3%	3.4%	3.5%	3.5%	3.5%	3.3%	3.3%	3.5%	3.8%	4.0%		
Consumer																					
GFK consumer conf	-9	-10	-7	-9	-7	-9	-10	-7	-9	-10	-13	-14	-14	-13	-13	-13	-10	-13	-11	-14	-12
Retail sales ex fuel y/y%	4.9%	4.3%	3.2%	2.9%	6.4%	4.5%	5.2%	4.7%	4.2%	3.4%	4.2%	3.4%	4.2%	4.2%	6.6%	4.4%	2.1%	4.0%	3.6%	3.0%	
Barclaycard spending growth y/y%	3.9%	3.8%	2.0%	3.4%	5.1%	5.1%	5.0%	4.5%	3.9%	4.4%	3.3%	1.8%	2.9%	1.2%	3.1%	2.5%					
Lending																					
Mortgage lending y/y%	3.5%	3.5%	3.4%	3.4%	3.4%	3.4%	3.3%	3.3%	3.3%	3.3%	3.3%	3.2%	3.3%	3.2%	3.2%	3.2%	3.2%	3.1%	3.2%	3.2%	
Unsecured Lending y/y%	9.3%	9.4%	8.7%	8.8%	8.8%	8.8%	8.5%	8.2%	7.9%	7.4%	7.1%	6.6%	6.6%	6.5%	6.4%	6.0%	5.7%	5.5%	5.6%	5.4%	
Credit card lending y/y%	9.5%	9.6%	8.9%	8.9%	9.3%	9.4%	8.9%	8.9%	8.6%	8.2%	7.8%	7.0%	6.5%	6.3%	6.6%	5.8%	5.5%	5.0%	5.2%	4.9%	

Source: Datastream, Bloomberg, Barclaycard.

Dovish central banks are a consolation, but markets expect a lot already

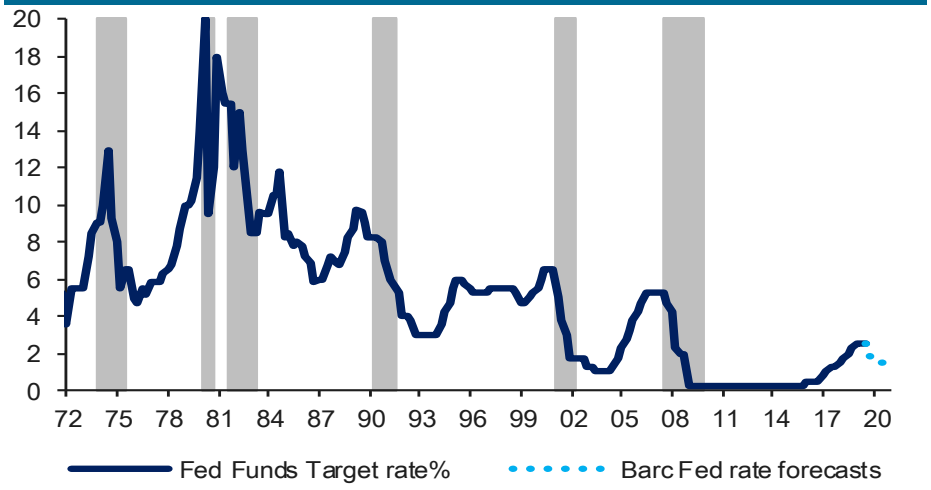
- The U-turn by the Fed in January triggered a strong rally in risk assets.
- Following the initial 25bp rate cut in July, and the most recent in Sept, our economists expect the Fed to deliver another 50bp rate cuts by end of Jan, amid weakening global growth and inflation prospects.
- However, with the market already pricing in several additional rate cuts over the next year, the Fed put looks to be baked in. In other terms, the Fed might struggle to deliver another strong positive surprise to the market. This is particularly the case as core CPI is on the way up again.

Market is pricing another 4 cuts from Fed



Source: Bloomberg, Barclays Economic Research

Fed funds vs. US recessions



Source: Bloomberg, NBER, Barclays Economic Research

US core CPI has rebounded ytd

Source: Bloomberg

Pre-emptive rate cuts helped equities in the past

- Equities performed well on most occasions following past initial Fed cuts; bond yields did not necessarily fall.

S&P500 performance around previous Fed cuts

Rate cut date	SPX Performance around first rate cut					
	-3m	-1m	+1m	+3m	+6m	+12m
Jun-74	8.5%	1.7%	-5.9%	-21.4%	-23.3%	5.3%
Mar-80	3.6%	11.3%	3.7%	13.8%	26.8%	31.5%
May-81	-1.5%	0.2%	-0.5%	-5.8%	-8.3%	-12.6%
Sep-84	-7.5%	0.3%	-0.8%	0.2%	7.1%	9.2%
May-89	-9.2%	-3.9%	-0.3%	9.8%	6.7%	10.6%
Jul-95	-7.5%	-2.1%	2.1%	6.3%	12.2%	21.9%
Sep-98	9.3%	-8.7%	1.8%	16.9%	20.9%	25.7%
Jan-01	11.9%	3.2%	6.4%	-9.6%	-5.6%	-11.2%
Sep-07	2.5%	-2.1%	4.2%	0.8%	-10.6%	-13.7%
Median	**2.5%**	**0.2%**	**1.8%**	**0.8%**	**6.7%**	**9.2%**
Average	**1.1%**	**0.0%**	**1.2%**	**1.2%**	**2.9%**	**7.4%**

Source: Datastream, Barclays Research

Bond yields move around previous Fed cuts

	US 10Y yield around the first rate cut (bp)					
Rate cut date	-3m	-1m	+1m	+3m	+6m	+12m
Mar-80	229	-10	-189	-317	-77	50
May-81	-20	-69	45	182	-18	37
Sep-84	-139	-40	-73	-101	-82	-217
May-89	-66	-42	-57	-37	-77	-2
Jul-95	-91	10	30	-7	-53	59
Sep-98	-86	-47	-5	14	67	139
Jan-01	-76	-41	5	-13	28	-7
Sep-07	-62	-20	8	-28	-101	-98
Median	**-71**	**-41**	**0**	**-21**	**-65**	**18**
Average	**-39**	**-32**	**-29**	**-39**	**-39**	**-5**

Source: Datastream, Barclays Research

US sectors performance following past Fed cuts

	Median performance around first rate cut						Average performance around first rate cut					
	-3m	-1m	+1m	+3m	+6m	+12m	-3m	-1m	+1m	+3m	+6m	+12m
S&P 500	**2.5%**	**0.2%**	**1.8%**	**0.8%**	**6.7%**	**9.2%**	**1.1%**	**0.0%**	**1.2%**	**1.2%**	**2.9%**	**7.4%**
Financials	0.5%	-2.0%	2.2%	6.2%	11.5%	10.4%	3.8%	-0.3%	1.7%	2.7%	7.3%	8.5%
Oil & Gas	-2.1%	-1.0%	1.4%	1.6%	-0.2%	14.5%	0.6%	-0.1%	0.6%	0.3%	3.2%	6.9%
Materials	-0.2%	-1.3%	0.0%	0.3%	1.2%	5.6%	-0.9%	-0.3%	0.6%	0.4%	-0.6%	6.3%
Industrials	1.1%	0.9%	1.1%	2.1%	3.0%	10.0%	1.3%	0.6%	0.3%	-1.4%	1.6%	10.1%
C Svs	3.6%	-2.3%	1.6%	0.3%	4.4%	6.1%	0.3%	-0.7%	1.1%	0.8%	3.9%	11.4%
Tech	-2.0%	-1.6%	-1.4%	0.9%	-7.6%	-0.3%	4.0%	0.5%	1.9%	-1.2%	-1.5%	8.3%
C Gds	-0.2%	-1.7%	0.7%	4.1%	4.3%	0.1%	1.5%	0.0%	0.9%	1.2%	-0.1%	2.7%
Healthcare	-3.7%	-2.0%	1.6%	4.8%	13.8%	5.4%	-2.3%	-1.8%	-0.4%	0.6%	4.6%	11.2%
Telecom	-3.7%	-3.2%	2.5%	2.6%	9.2%	9.0%	-0.4%	-2.8%	2.4%	4.5%	5.7%	6.6%
Utilities	-2.9%	-2.0%	2.4%	5.4%	7.1%	7.9%	1.3%	-1.0%	2.1%	4.8%	3.2%	3.8%

Source: Datastream, Barclays Research

ECB still has policy options available

Cross asset performance under different ECB policy options

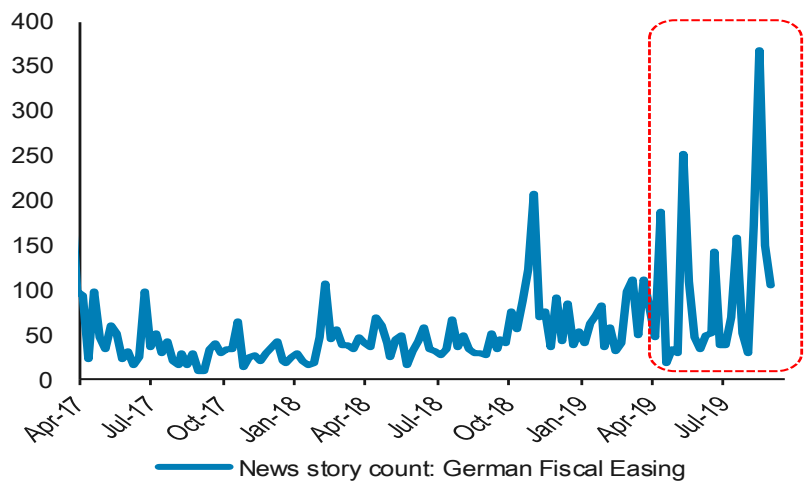
QE options	Issue/r limit effect	Asset class focus	Monthly breakdown	Total net purchases over two years
Option 1: Operation Twist	None for all	Sovereign/Supra, possibly also Corp/Covered bonds	€15bn (duration equiv.)	Up to €360bn (duration equiv.)
Option 2: Maturity Limit Extension (31y+)	None for all	Sovereign/Supra, possibly also Corp bonds	€0bn unless combined with other options	€0bn unless combined with other options
Option 3: Restart pure credit/covered bond programme	None for all	Corp/Covered bonds	€20-25bn max (€10-20bn more likely)	€480-600bn max (€240-480bn more likely)
Option 4: "Hidden OMT"	None for sovereigns, potentially higher for supras	Sovereign/Supra, Corp/Covered bonds	€30-50bn (€20-30bn Sovereign/Supra, €10-20bn Corp/Covered)	€720-1200bn
Option 5: Small-size balanced QE with Sovereign issue/r limit unchanged	None for sovereigns, potentially higher for supras	Sovereign/Supra, Corp/Covered bonds	€20-30bn (€10-15bn Sovereign/Supra, €10-15bn Corp/Covered)	€480-720bn
Option 6: Raise issue/r limit for non-CAC Sovereigns	Higher for non-CAC sovereigns, potentially also supras	Sovereign/Supra, Corp/Covered bonds	€30-50bn (€20-30bn Sovereign/Supra, €10-20bn Corp/Covered)	€720-1200bn
Option 7: Small-size balanced QE with raised Sovereign issue/r limit	Higher for all sovereigns, likely also supras	Sovereign/Supra, Corp/Covered bonds	€20-30bn (€10-15bn Sovereign/Supra, €10-15bn Corp/Covered)	€480-720bn
Option 8: Bazooka – large scale QE with raised sovereign issue/r limit	Higher for all sovereigns, likely also supras	Sovereign/Supra, Corp/Covered bonds	€50-80bn (€40-60bn Sovereign/Supra, €10-20bn Corp/Covered)	€1.2tn-1.9tn
The outside chance: Buying equities	None	Equities	<10% of net Sovereign/Supra purchases	<10% of net Sovereign/Supra purchases

Source: Barclays Research

Fiscal stimulus would help but patience might be required

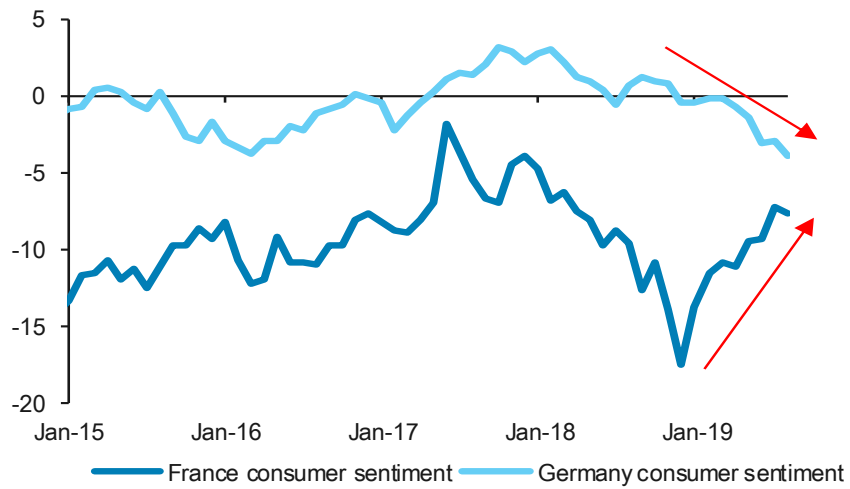
- The question is whether Germany, which has the biggest budget capacity in the region, will move away from its strict fiscal discipline anytime soon.
- The growing evidence of a weakening German economy calls for more pro-growth-oriented budget decisions, but we worry that it might take some time before spending is actually increased.

Expectations around a German fiscal easing have risen



Source: Barclays Research

There is a strong case for more spending in Germany

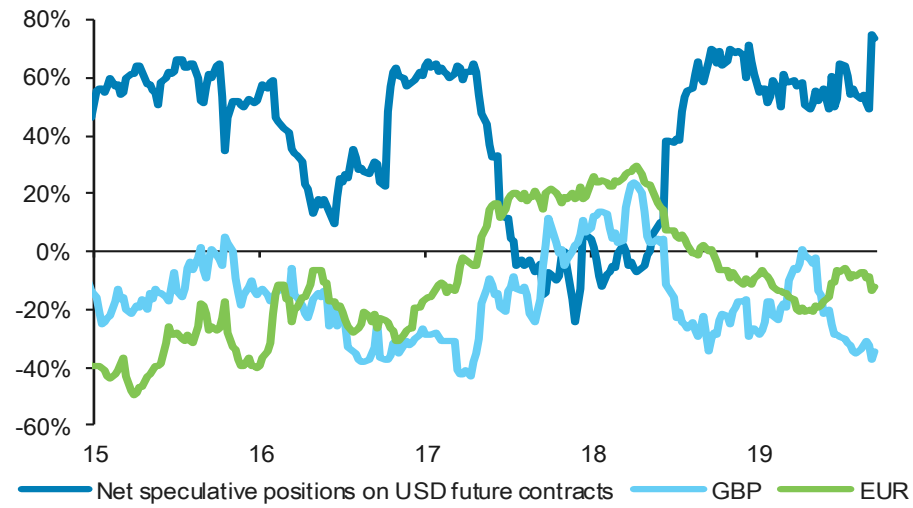


Source: Bloomberg, EC

Dollar - Positioning is stretched, but reversal looks unlikely for now

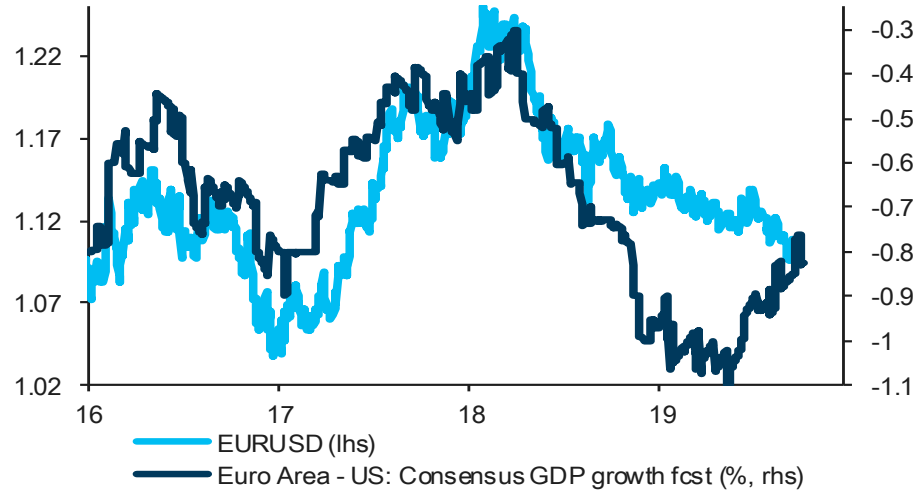
- Dollar remains well bid even though the Fed is cutting rates.
- As the other key DM central banks are also dovish while US growth remains stronger than the ROW, the dollar will continue to be supported, in our view.

USD is well owned and investors are short GBP



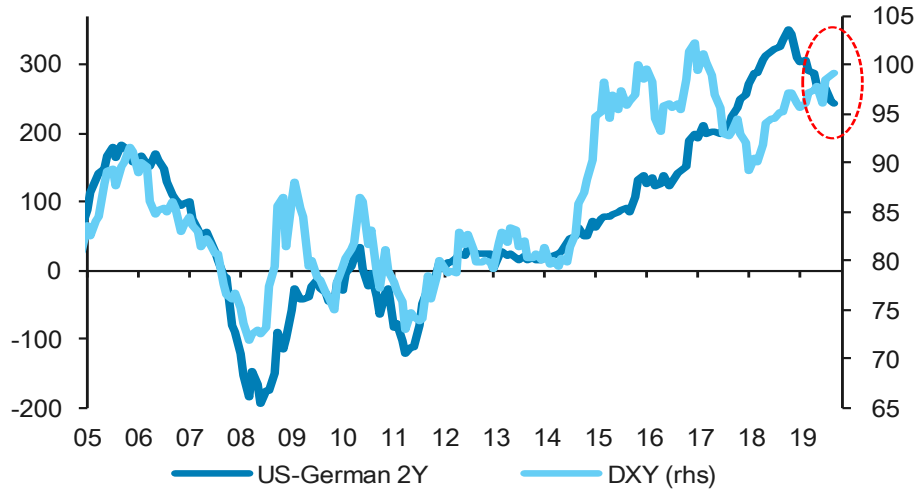
Source: CFTC, Bloomberg

EMU/US GDP Growth differential is narrowing



Source: Bloomberg, Datastream

Fed-ECB policy divergence is still a support for USD

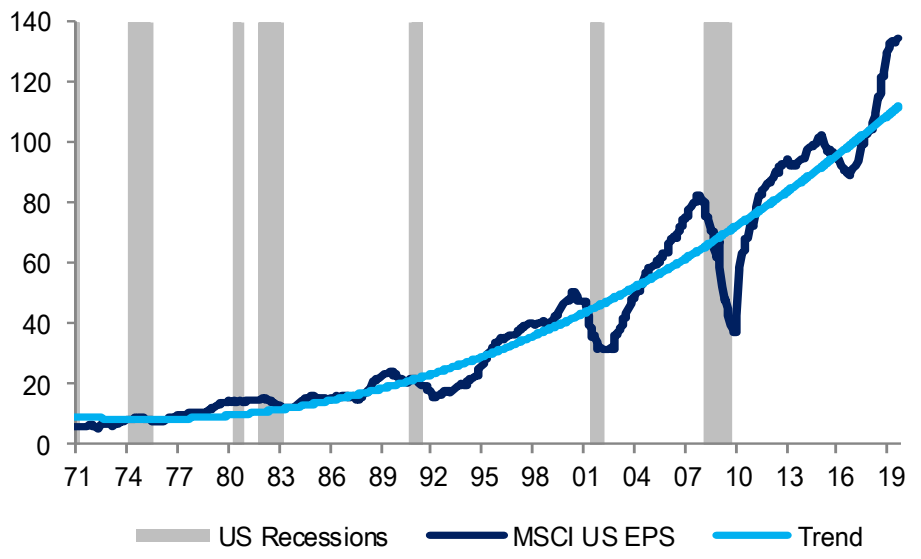


Source: Bloomberg, Datastream

Earnings
Flat is the new up

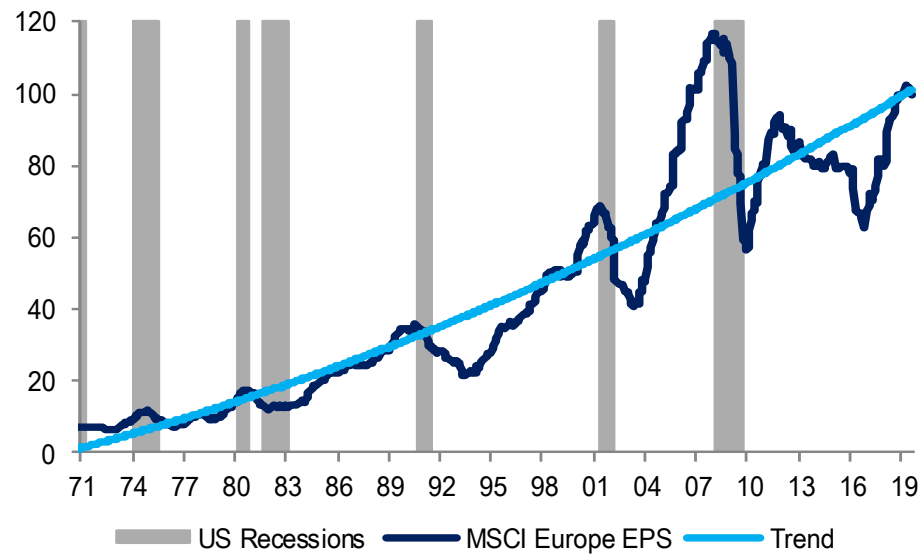
- US earnings are looking stretched in an historical context and are well-above the historical trend at present following their strong tax-cut-driven rebound in 2018.
- European earnings are not as stretched as the US ones, but still managed to rebound strongly and to grow above-trend in the last two years.
- Base effects have turned less favourable for 2019.

Earnings are well above the trend in the US...



Source: Datastream

...and are far from being depressed in Europe

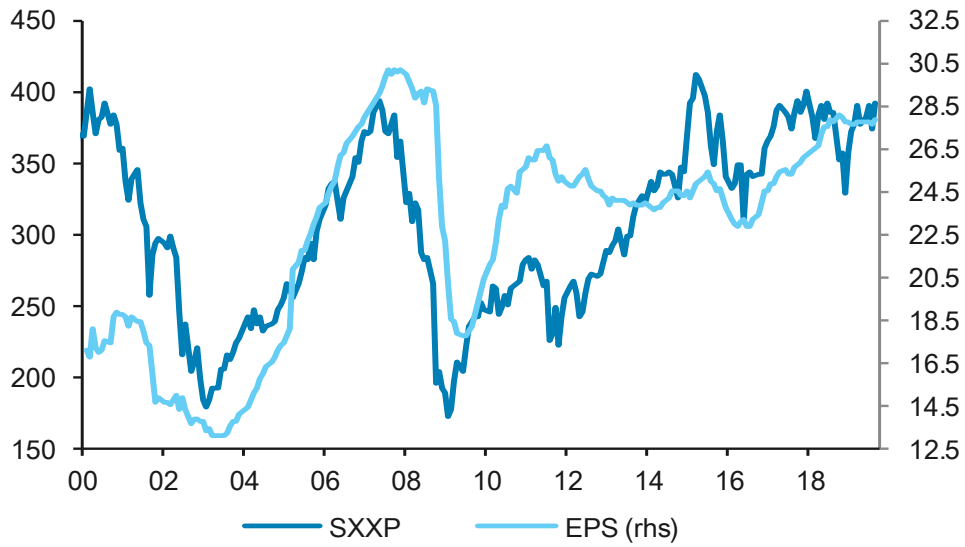


Source: Datastream

Earnings are the key medium-term driver of equities

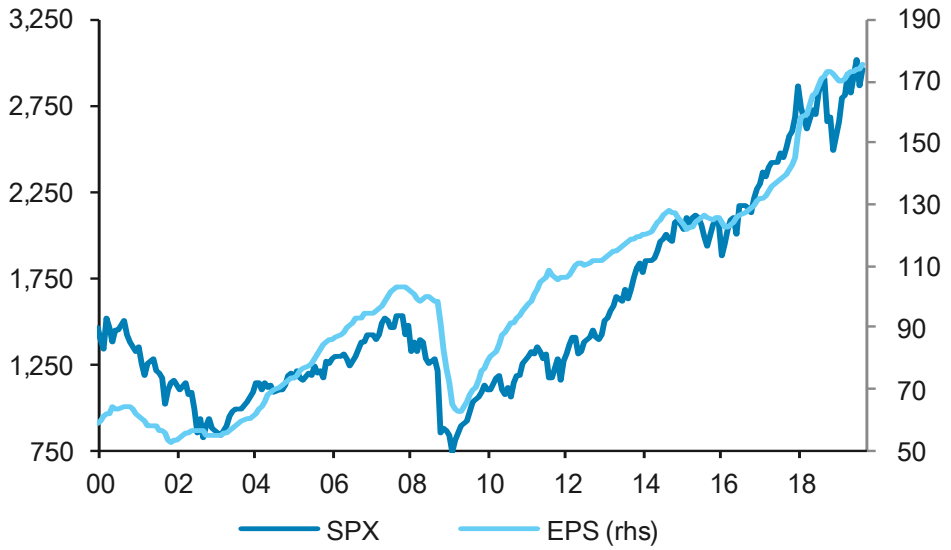
- The long-term fundamental relationship between equity prices and earnings remains strong.
- We believe that any sustainable melt-up scenario requires earnings to rebound rather than bond yields to fall.
- Dovish central banks provide a put to risk assets in the near term and somewhat artificially inflate their valuations. However, lower for longer interest rates will likely come with lower GDP growth, and thus lower EPS growth, over the long run.

Over the long run, equities move with earnings, in the US…



Source: IBES, Refinitiv

…and in Europe

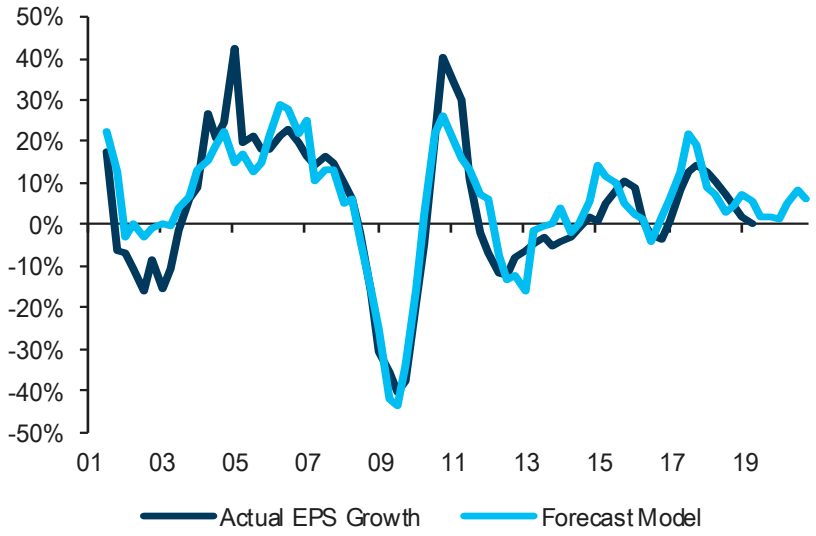


Source: IBES, Refinitiv

Looking for subdued EPS growth in 2019

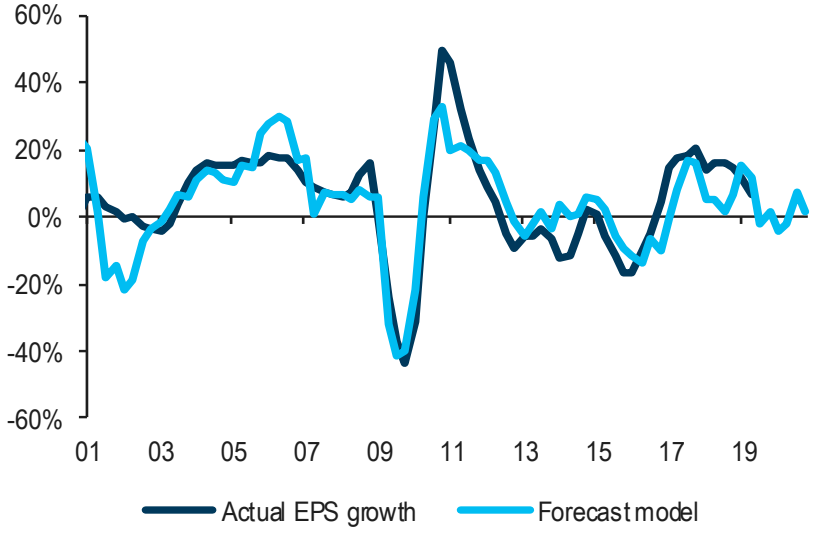
- Our earnings models forecast low single-digit growth of 1% for UK and 2% for Eurozone for 2019.
- For 2020 we forecast 1% and 4% respectively, both far lower than consensus.
- This is mostly due to the lower GDP forecasts provided by our economists, and the tailwind from FX we expect for 2019 is somewhat offset by flat-to-lower commodity prices over the forecast horizon.

We forecast Euro Stoxx EPS growth if 2% in '19 & 4% in '20



Source: IBES, Refinitiv, Bloomberg, Barclays Research

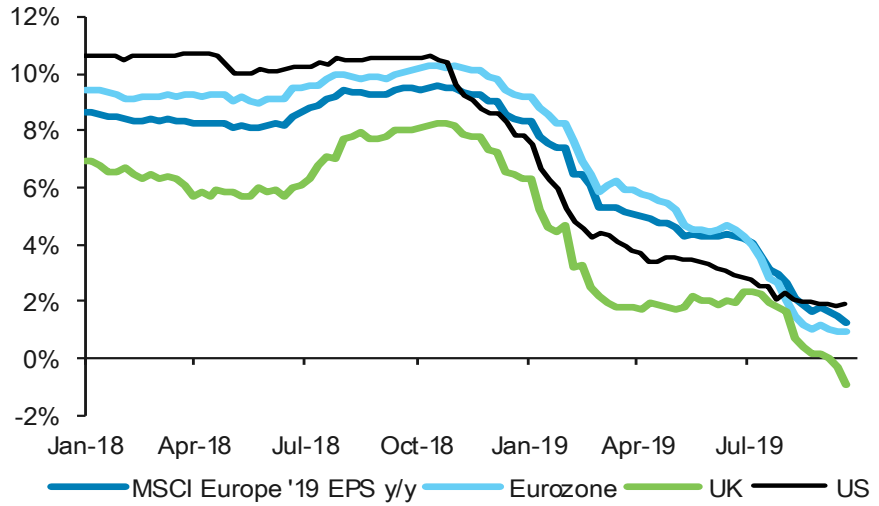
We forecast FTSE 100 EPS growth if 1% in '19 & 1% in '20



Source: IBES, Refinitiv, Bloomberg, Barclays Research

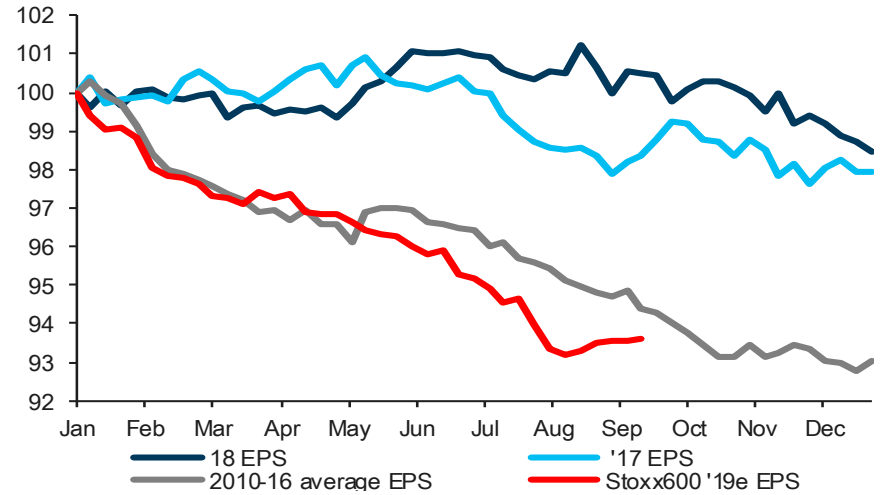
FY'19 estimates keep being lowered but the bar for FY'20 still looks high

2019 IBES EPS growth estimates are getting revised lower



Source: Datastream, IBES

Ytd EPS cuts contrast with the resilient forecasts of '17 and '18



Source: Datastream, IBES

IBES expectations for 2020 look optimistic

EPS y/y	2020e	Latest	on Dec 31, 2018	2018	2017
		2019	2019		
MSCI World	9.5%	1.7%	7.2%	14.5%	13.9%
US	10.5%	2.0%	7.8%	24.2%	10.6%
Europe	9.7%	1.3%	8.4%	6.0%	12.5%
UK	8.3%	-0.9%	6.3%	11.2%	21.6%
Eurozone	10.6%	1.0%	9.2%	3.4%	10.4%
Germany	13.8%	-3.0%	10.3%	-5.7%	9.7%
France	10.9%	1.3%	8.8%	8.0%	6.5%
Italy	7.0%	5.4%	10.4%	19.1%	24.6%
Spain	6.7%	2.2%	7.9%	7.7%	12.3%
Japan	7.6%	5.8%	5.6%	-4.9%	30.3%
EM	13.4%	2.3%	8.9%	7.5%	22.6%

Source: IBES

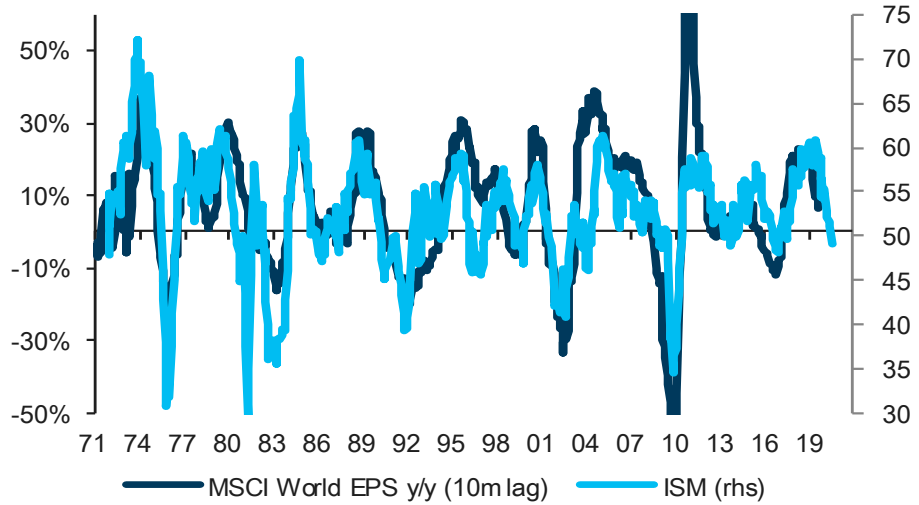
Consensus foresees a pick-up in earnings for 2020

	MSCI Europe			
	EPS growth%		Sales growth%	
	2019E	2020E	2019E	2020E
Comm. Svs	1.8%	9.0%	3.1%	1.4%
C Disc	-2.8%	12.9%	2.9%	3.0%
C Staples	9.0%	7.9%	2.4%	3.4%
Energy	-7.7%	19.5%	-5.9%	1.0%
H Care	4.4%	9.2%	6.1%	5.2%
Industrials	8.1%	9.9%	5.1%	3.5%
Financials	2.6%	5.2%	3.5%	2.2%
Info Tech	7.8%	19.7%	5.4%	5.8%
Materials	-12.9%	9.1%	0.7%	1.1%
Utilities	6.9%	9.4%	5.6%	12.3%
Real Estate	3.1%	2.8%	1.6%	3.3%
Market	1.5%	9.7%	2.1%	3.2%
Ex Energy	2.5%	8.7%	3.5%	3.6%
Ex Fin	1.1%	11.2%	1.8%	3.4%
Cyclicals	-0.8%	11.7%	3.3%	2.9%
Defensives	6.0%	8.7%	4.0%	5.4%

Source: Datastream, IBES

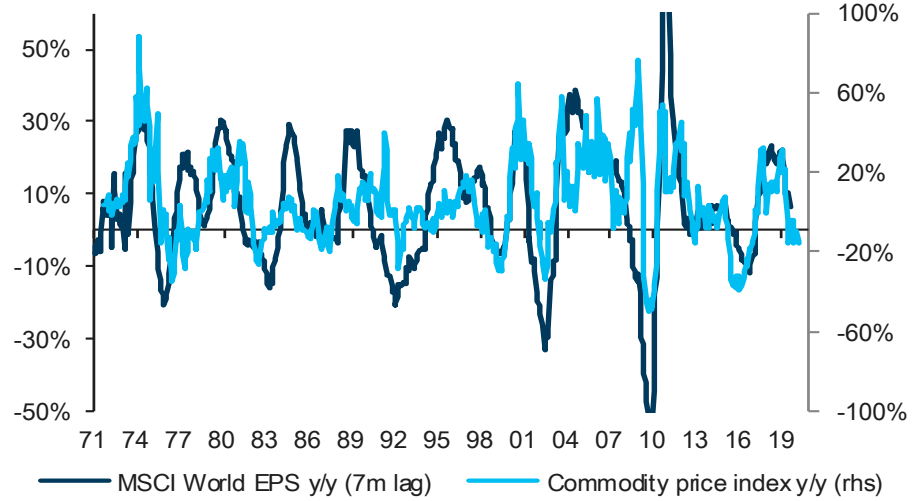
Top-line drivers have peaked...

MSCI World EPS growth vs ISM



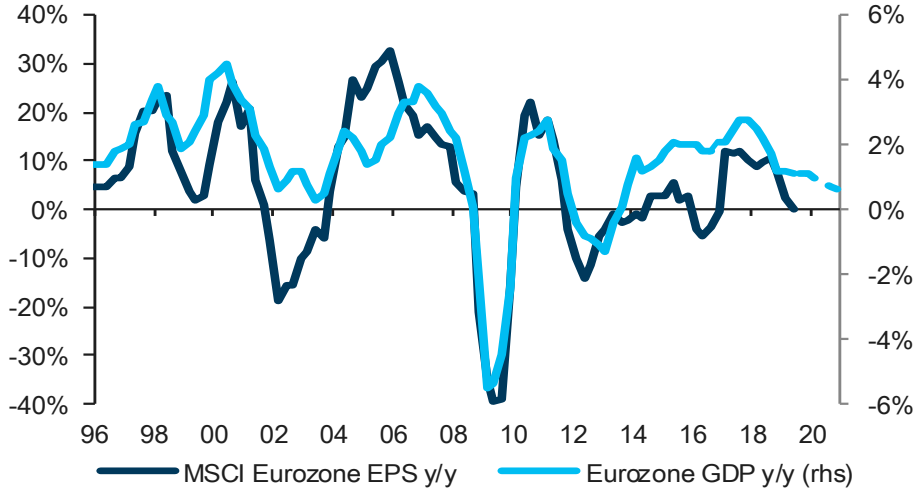
Source: Datastream

Commodity prices are positively correlated with earnings



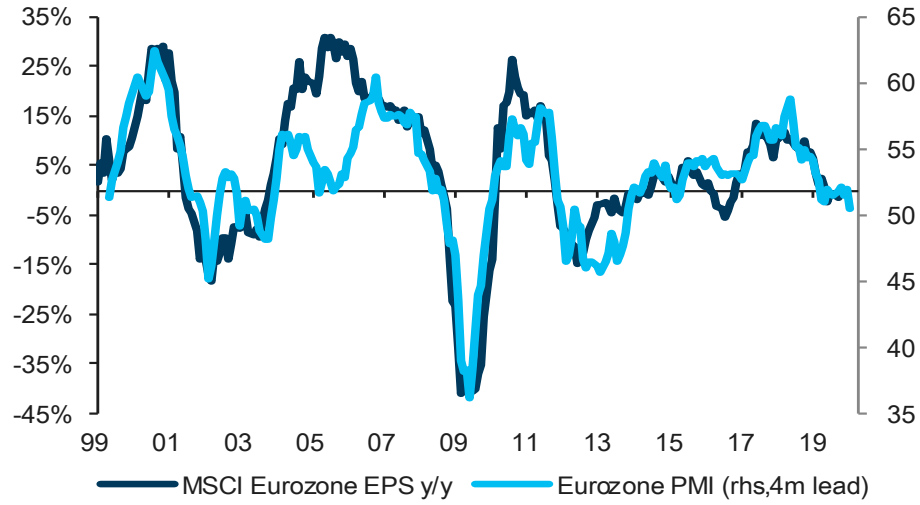
Source: Datastream, Bloomberg

Weaker GDP growth means weaker EPS growth



Source: IBES, Barclays Research

Current Eurozone PMI points to zero EPS growth

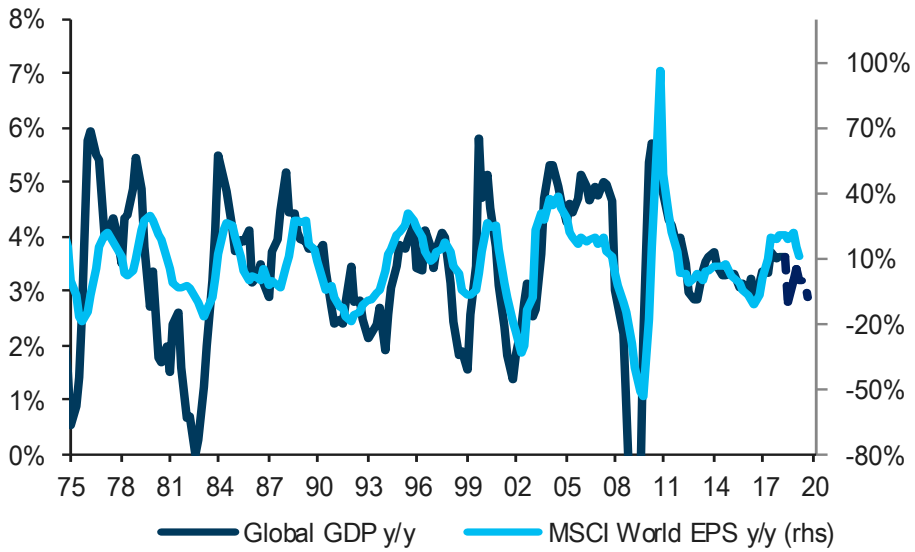


Source: IBES, Bloomberg

...global GDP growth is just above the threshold for positive EPS growth

- The strong rebound in earnings of the last two years coincided with the global and synchronised recovery.
- Softer activity coupled with less favourable base effects will result in much lower EPS growth in 2019.
- Our economists' forecast of 3.1% global GDP growth for 2019 is just above the typical 3% threshold for positive EPS growth.

Global GDP growth vs EPS growth



Source: Bloomberg, Datastream

EPS growth in different Global GDP growth regimes

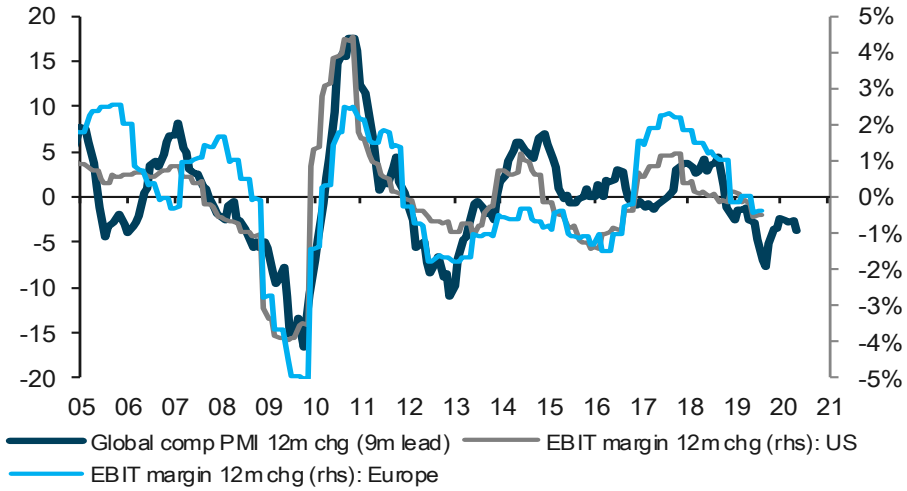
Global Real GDP y/y	MSCI World EPS y/y	MSCI US EPS y/y	MSCI Europe EPS y/y
<2%	-6.6%	-4.7%	-1.4%
2-2.5%	-8.2%	-3.1%	-9.5%
2.5-3%	-4.4%	2.1%	-9.4%
3-3.5%	**1.7%**	**2.2%**	**3.6%**
3.5-4%	12.8%	9.2%	13.3%
4-5%	17.5%	13.7%	18.1%
>5%	14.5%	15.9%	10.3%

Source: Datastream, median trailing EPS growth

Margins are vulnerable…

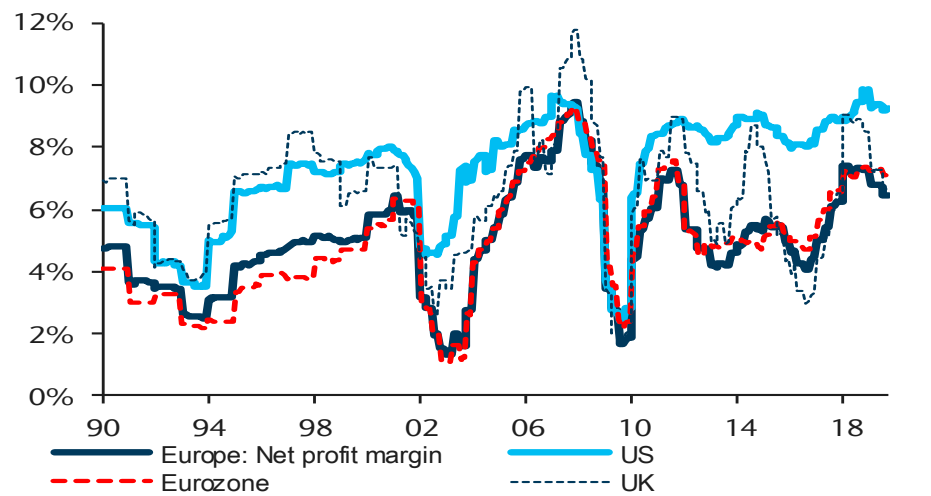
- Both top line and profit margins have contributed to the strong rebound in earnings over the last two years.
- However, margins are near the cycle-highs in most regions at present and are unlikely to expand anymore if activity keeps weakening.
- Margins are indeed cyclical and follow the top-line direction.

Margins are cyclical and move with activity indicators



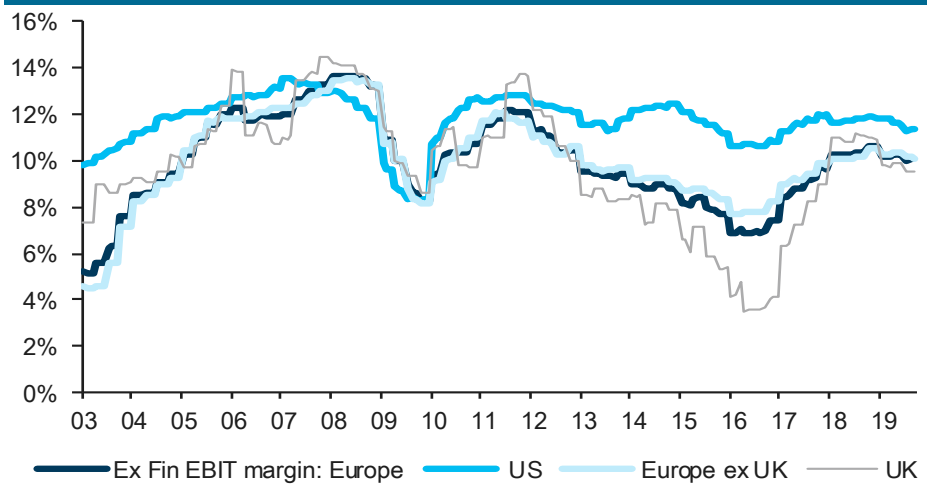
Source: Datastream, Barclays Research

Net profit margins are at cycle highs



Source: Worldscope, Barclays Research

Operating margins too

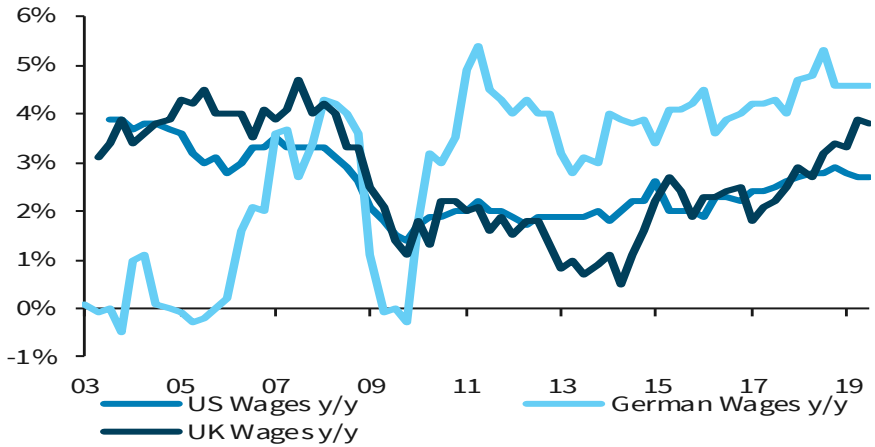


Source: Worldscope, Barclays Research

…wage inflation is on the rise…

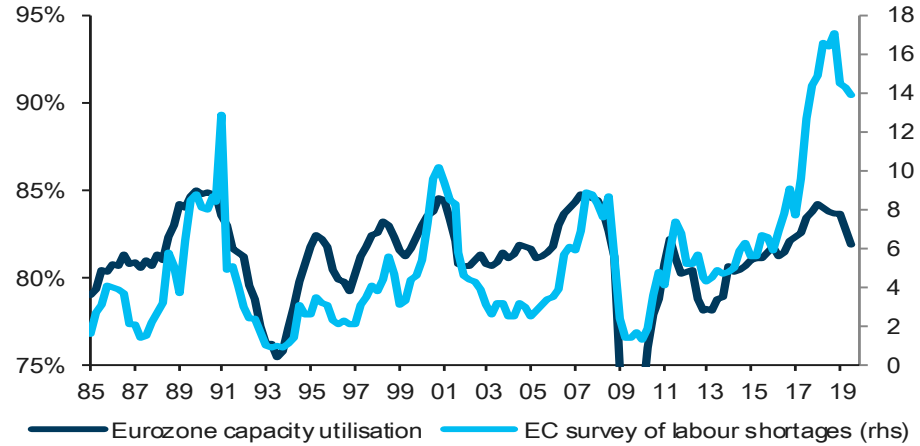
- Wage growth is firming up both in US and Europe. The increase in Unit Labour Costs remains modest by historical standards, though, and is running at about the same level as overall inflation

Wage growth is rising in US and Europe



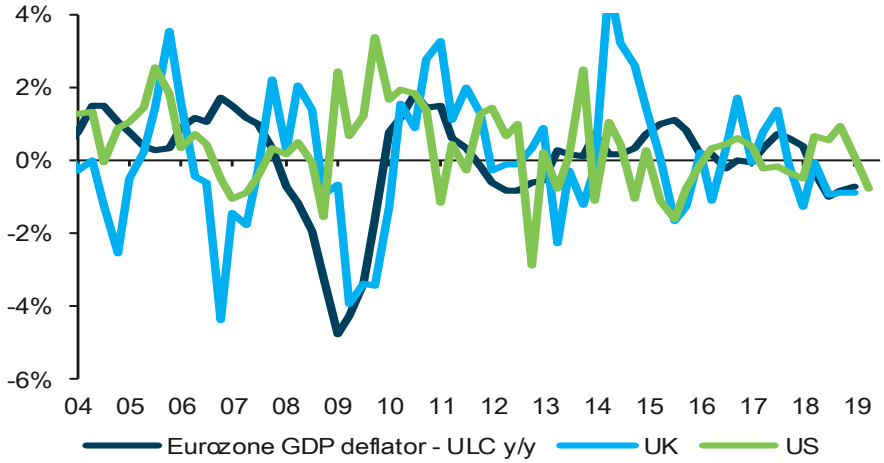
Source: Bloomberg

Eurozone labour shortages are elevated



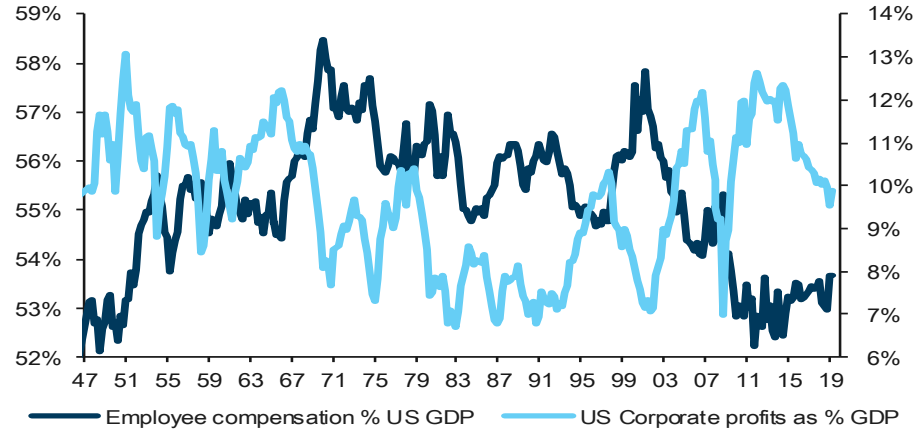
Source: Bloomberg. Barclays Research

Unit Labour Costs are growing at about the same pace as GDP deflator



Source: Bloomberg

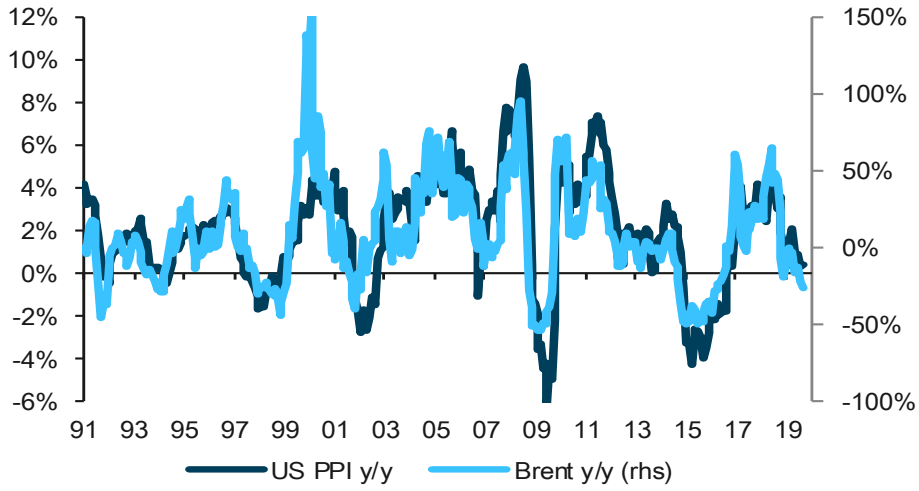
The gap between US profit and wage shares of GDP is narrowing



Source: BEA

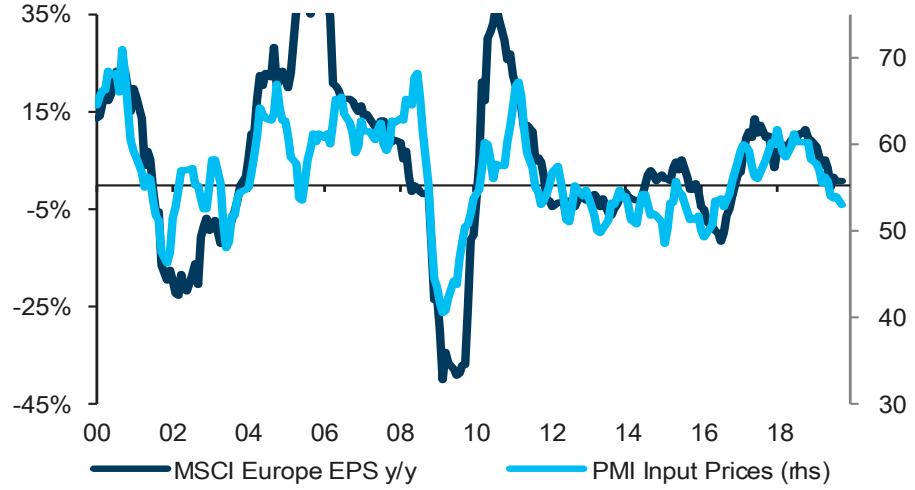
…but overall input cost inflation is contained

Corporate pricing indicators are closely tied to the direction of the oil price



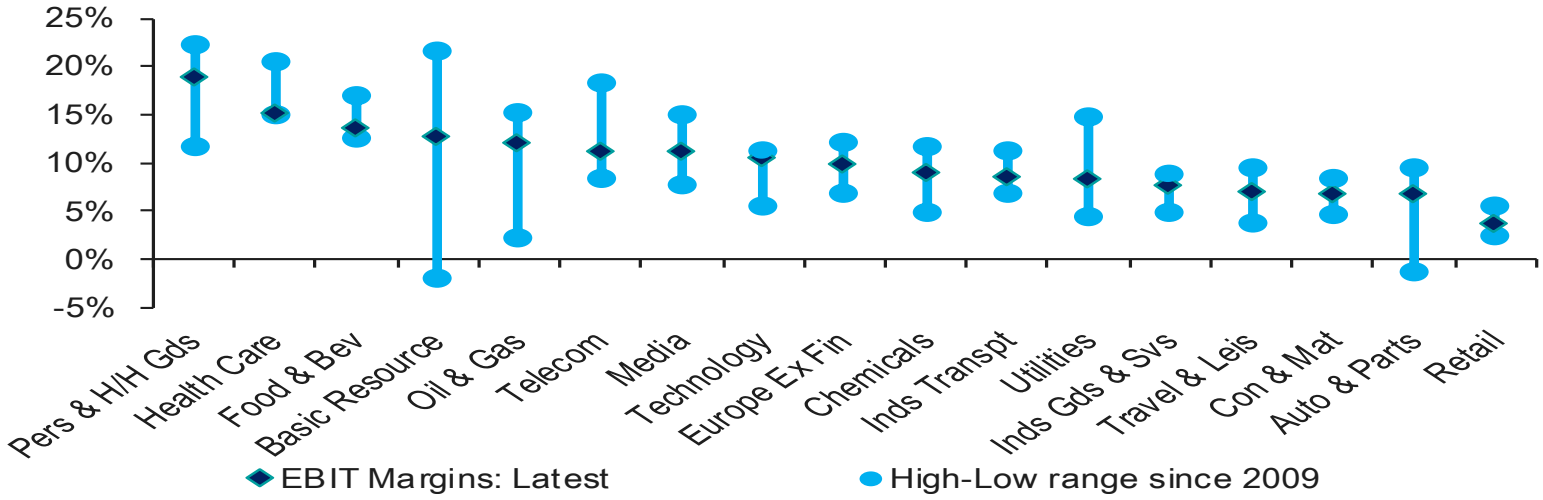
Source: Bloomberg

Eurozone earnings vs. PMI input costs



Source: Datastream, Markit, Bloomberg

European sectors operating margins in their historical context

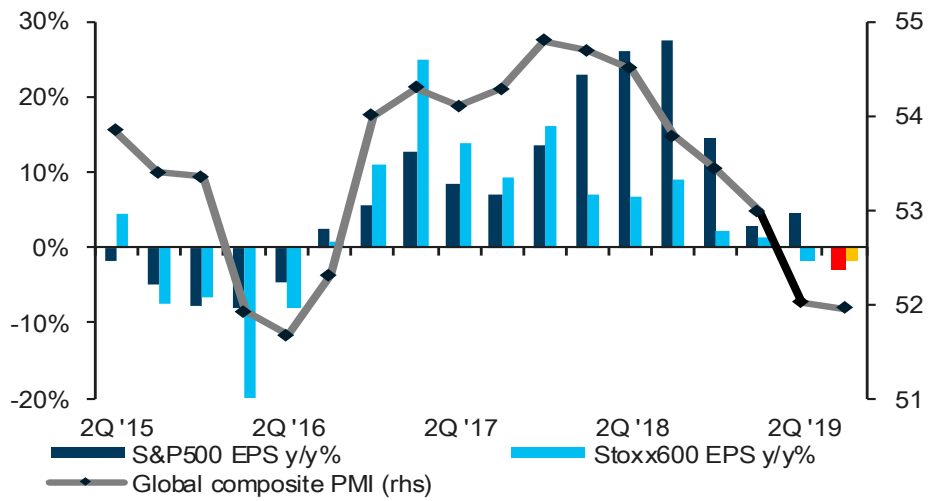


Source: Datastream, Barclays Research

Q2 earnings were unexciting…

- 78% of US companies beat EPS estimates and 56% in Europe, which is above average. EPS growth delivered in Q2 was higher than expected at +4.4% vs.-2% in the US and -2% vs.-4% in Europe which is the lowest level in 12 quarters.
- Stock prices reacted positively to earnings releases, as consensus estimates had been well-managed, while guidance was generally upbeat.

EPS growth is slowing along with activity momentum



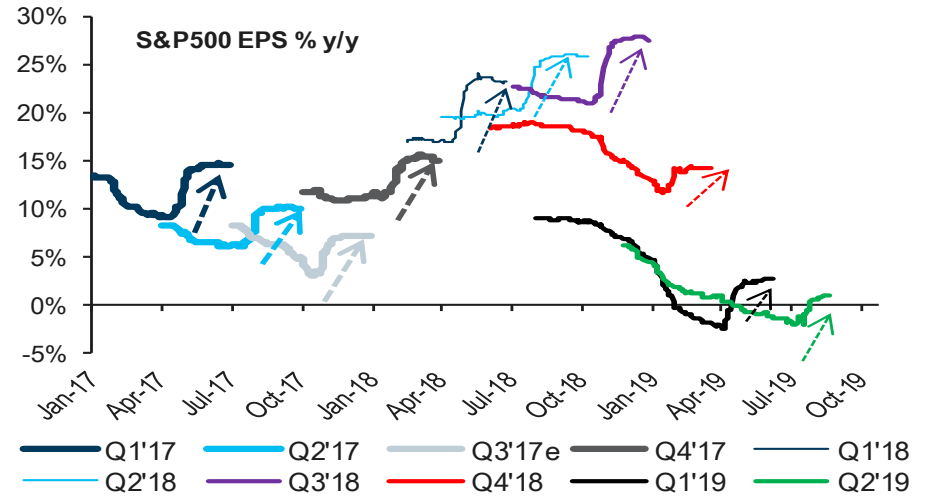
Source: Bloomberg, Barclays Research

Q2'19 results key stats for Europe and US

Results snapshot	SXXP				SPX			
	Sales y/y	Sales beats	EPS y/y	EPS beats	Sales y/y	Sales beats	EPS y/y	EPS beats
Energy	-2.3%	75%	-2.1%	63%	-2.1%	50%	-7.3%	71%
Materials	-2.0%	43%	-50.1%	32%	-22.4%	29%	-21.6%	83%
Industrials	4.9%	43%	18.8%	39%	1.3%	45%	3.3%	68%
Tech	9.6%	72%	15.0%	72%	-0.1%	67%	0.1%	90%
Cons. Disc.	2.4%	47%	-16.8%	29%	5.0%	57%	6.7%	83%
Comm. Svcs.	2.1%	35%	-4.8%	37%	13.9%	57%	14.8%	91%
Cons. Stap.	5.0%	45%	-2.6%	80%	1.9%	57%	-0.9%	81%
Healthcare	6.2%	77%	5.8%	64%	13.8%	72%	12.7%	93%
Utilities	-4.5%	41%	29.9%	67%	-0.1%	26%	3.7%	44%
Financials	2.1%	71%	-0.2%	86%	2.4%	66%	4.2%	76%
Market	**1.4%**	**55%**	**-1.8%**	**56%**	**4.0%**	**55%**	**4.4%**	**78%**
Market ex Energy	**2.4%**	**55%**	**-1.8%**	**57%**	**4.7%**	**56%**	**5.1%**	**80%**
Market ex Fins	**1.2%**	**53%**	**-2.7%**	**51%**	**4.2%**	**54%**	**4.4%**	**80%**
Cyclicals	**3.0%**	**49%**	**-10.7%**	**42%**	**-0.5%**	**53%**	**0.5%**	**80%**
Defensives	**1.3%**	**53%**	**7.1%**	**59%**	**9.9%**	**57%**	**10.1%**	**81%**

Source: Bloomberg, Barclays Research

Q2 results delivered softer than ususal beats on well-managed expectations



Source: IBES, Refinitiv

…the bar for Q3 has come down, but it is higher for Q4

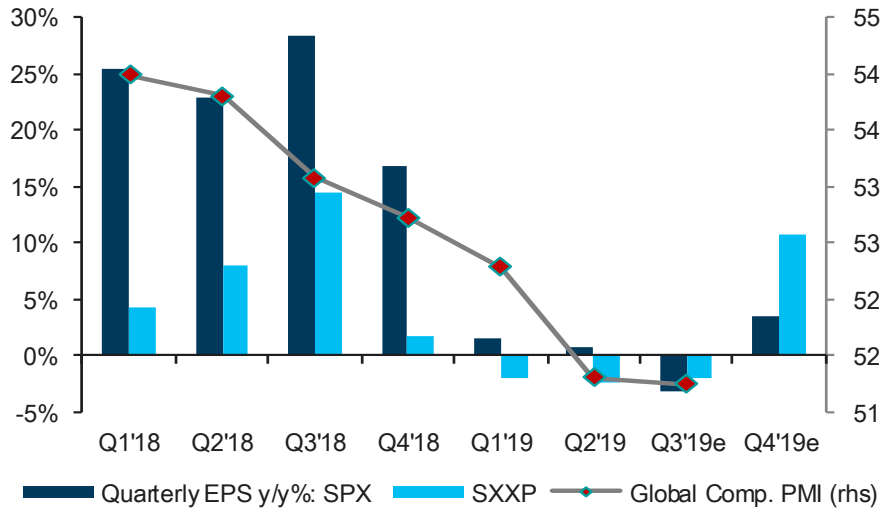
- Consensus estimates for Q3 y/y EPS growth do not look elevated to us and are outright negative.
- However, FY'19 expectations are disproportionately loaded towards Q4, and seem to be implying a pick-up in activity momentum.

Consensus is looking for negative y/y EPS growth in Q3'19

Q3'19 EPS y/y%	SPX	SXXP
C Disc	1.5%	0.3%
C Staples	-0.6%	21.8%
Energy	-29.3%	-16.9%
Financials	4.2%	-2.5%
H Care	2.4%	2.8%
Industrials	1.4%	9.7%
Materials	-9.9%	-27.0%
Tech	-7.4%	-3.7%
Comm Svs	-0.6%	12.4%
Utilities	2.2%	18.1%
Market	**-2.2%**	**-1.9%**

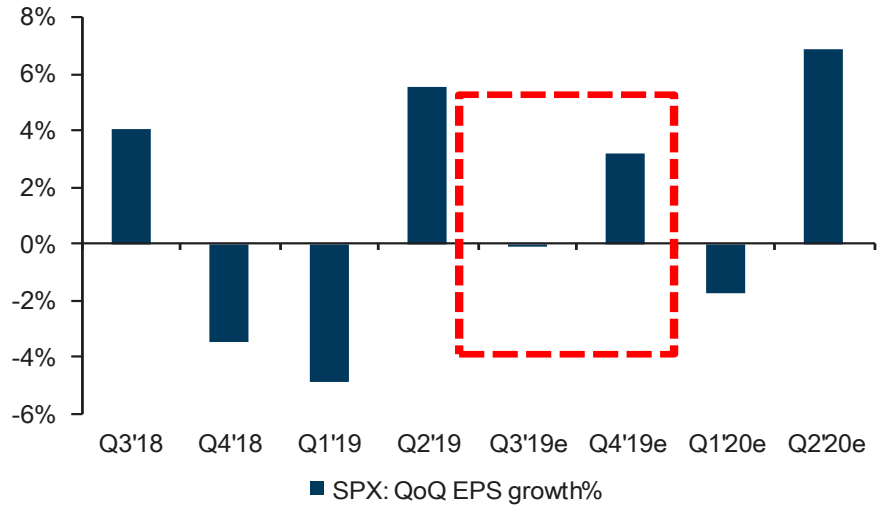
Source: Thomson Reuters, Refinitiv

2019 EPS growth expectations is disproportionately loaded towards Q4 implying a macro recovery



Source: IBES, Refinitiv

Q/Q EPS growth estimates look for flat growth in Q3 and low single digit growth in Q4



Source: IBES, Refinitiv

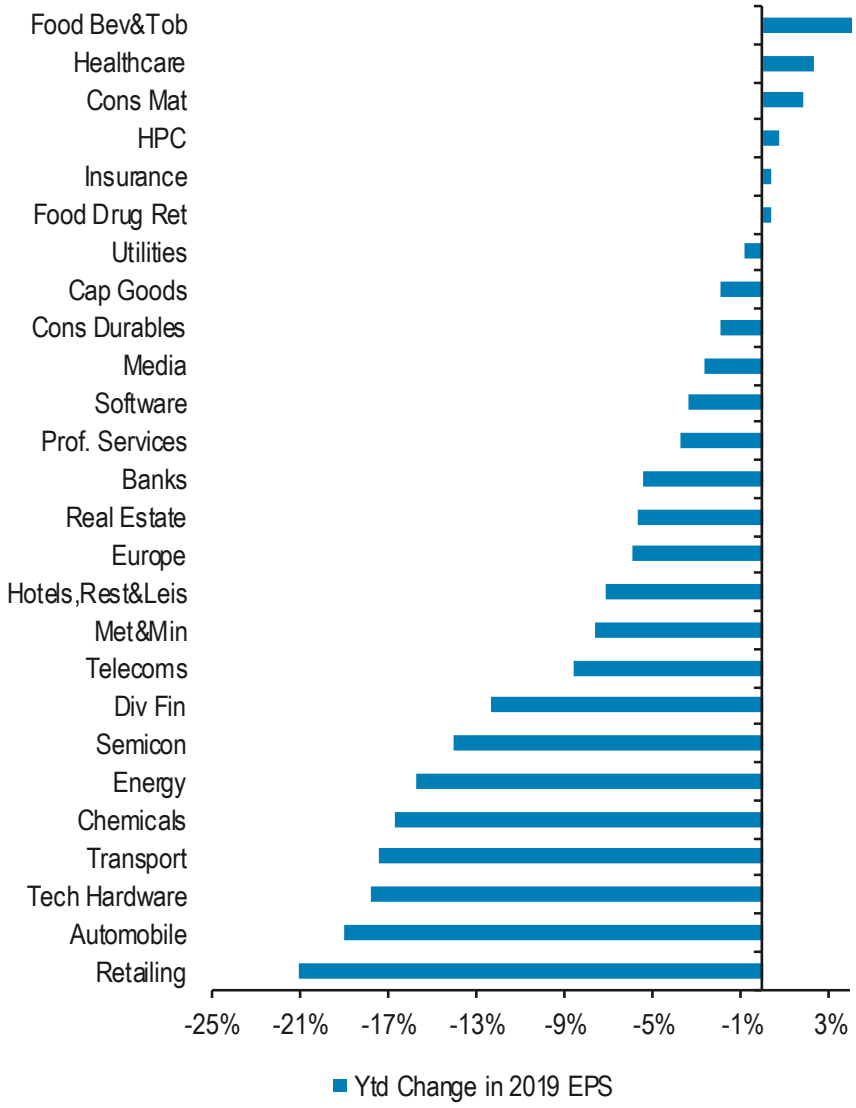
Cyclicals have seen the biggest downgrades ytd…

Consensus EPS growth estimates for 2019 vs. 2018

	EPS y/y	
	2018	2019e
Europe	6.0%	1.3%
Energy	38.6%	-7.7%
Chemicals	-4.0%	-15.0%
Cons Mat	-12.3%	23.6%
Met&Min	15.6%	-17.5%
Cap Goods	7.3%	7.0%
Prof. Services	0.2%	9.7%
Transport	-15.8%	15.1%
Automobile	-9.7%	-8.1%
Cons Durables	16.0%	7.0%
Media	-3.4%	0.8%
Retailing	-3.9%	-2.6%
Hotels,Rest&Leis	7.4%	-3.7%
Food Drug Ret	12.2%	10.3%
Food Bev&Tob	6.2%	10.4%
HPC	5.3%	4.4%
Healthcare	3.7%	3.2%
Banks	10.3%	-3.1%
Div Fin	-11.9%	3.2%
Insurance	12.9%	13.1%
Real Estate	5.9%	3.1%
Software	2.3%	8.7%
Tech Hardware	-19.3%	32.7%
Semicon	19.4%	-3.3%
Telecoms	-10.8%	1.5%
Utilities	-6.0%	6.9%

Source: IBES

Ytd change in 2019 EPS growth estimates

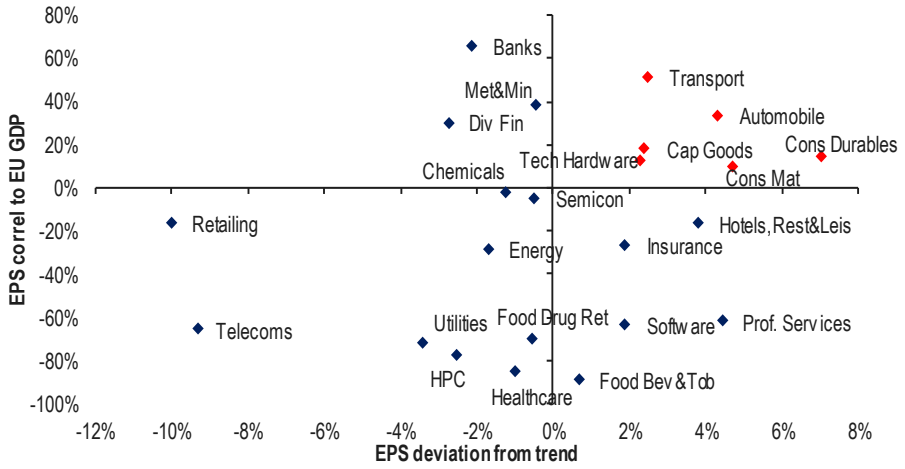


Source: IBES

…but earnings still look stretched in a long-term context for many of them

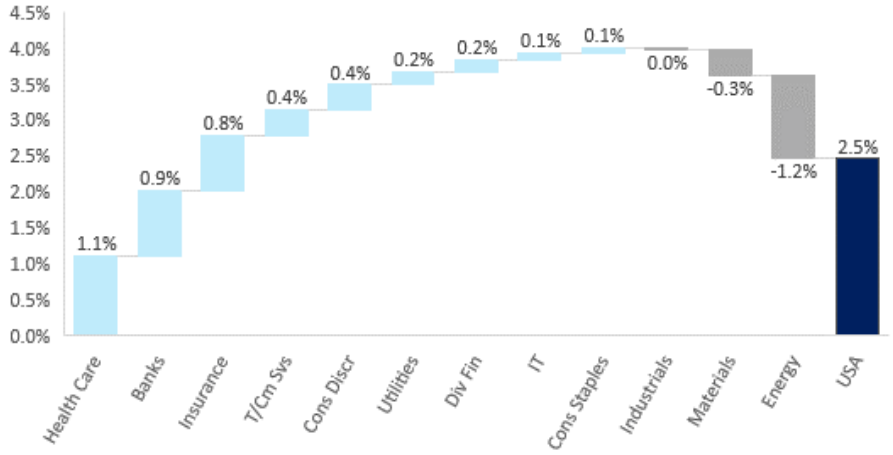
- Even accounting for the recent downgrades, many global cyclicals have earnings at or near historical highs at present.

Europe sector EPS vs. trend and EPS correlation to GDP growth



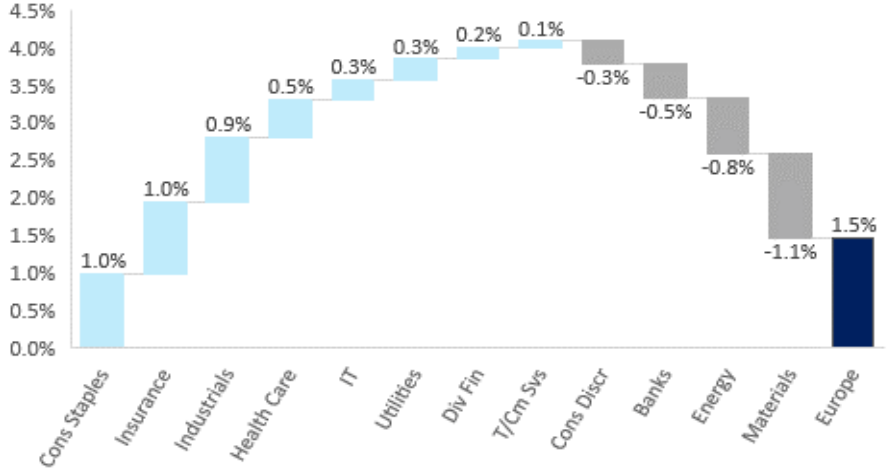
Source: Bloomberg, Datastream, IBES, Barclays Research

Sector contribution to MSCI US '19e EPS growth



Source: IBES

Sector contribution to MSCI Europe '19e EPS growth

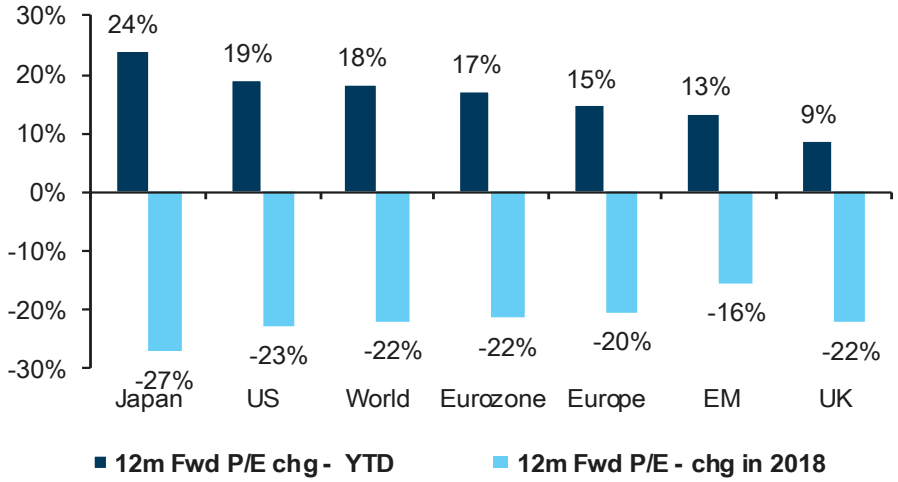


Source: IBES

Valuations

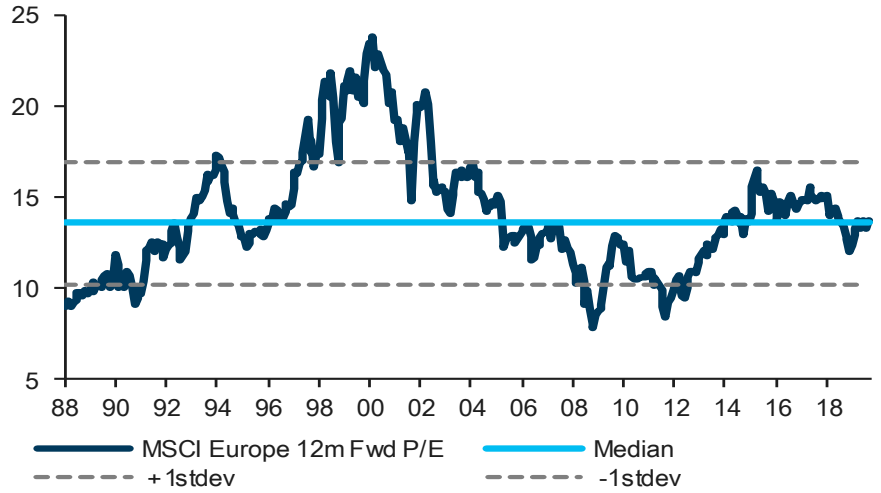
Equities look fairly valued

P/E multiples de-rated sharply in 2018 but have re-rated partially ytd



Source: Datastream

MSCI Europe P/E is again back up to the historical median



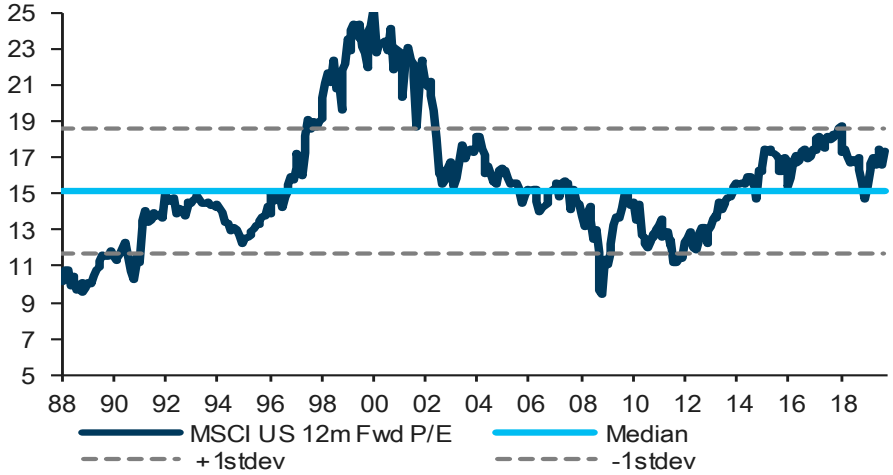
Source: IBES

Regional P/E multiples in the long-term context

	Current	10Y Median	20Y Median	Current vs 10Y Median	Current vs 20Y Median
MSCI World	**15.9**	**14.8**	**15.1**	**8%**	**6%**
US	**17.4**	**15.6**	**15.8**	**12%**	**10%**
Europe	**13.8**	**13.4**	**13.7**	**3%**	**1%**
UK	12.2	12.5	13.0	-2%	-6%
Eurozone	13.4	13.0	13.3	4%	1%
France	14.0	13.2	13.4	6%	4%
Germany	13.1	12.4	12.7	6%	3%
Italy	11.0	11.4	12.8	-4%	-14%
Spain	11.2	11.7	12.9	-4%	-13%
Japan	**13.3**	**13.5**	**15.2**	**-1%**	**-12%**
EM	**12.0**	**11.1**	**11.0**	**8%**	**9%**
Brazil	12.3	10.6	9.7	16%	27%
Russia	5.6	5.3	6.2	7%	-9%
India	17.3	16.6	15.7	4%	10%
China	11.3	10.6	11.4	7%	0%

Source: IBES

MSCI US P/E is above the historical median

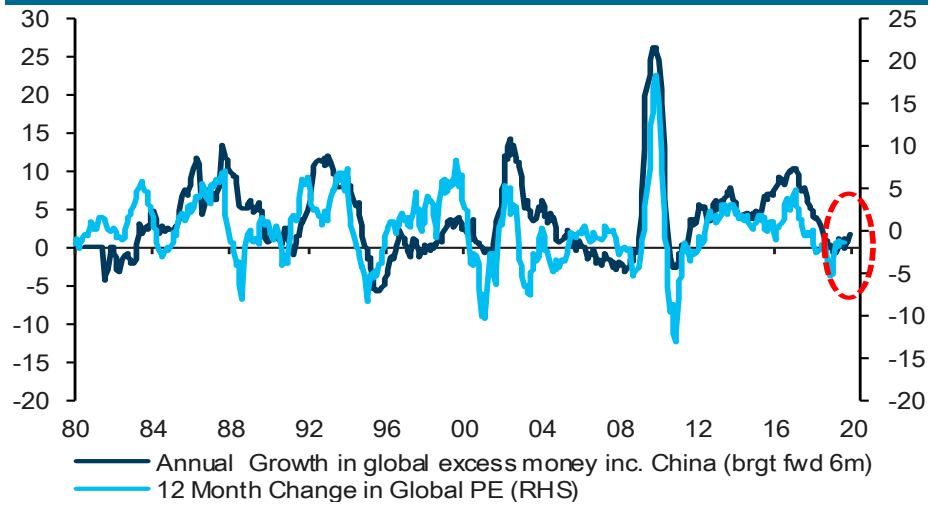


Source: IBES

Tightening central banks' liquidity hurt asset prices in 2018; the opposite is happening YTD

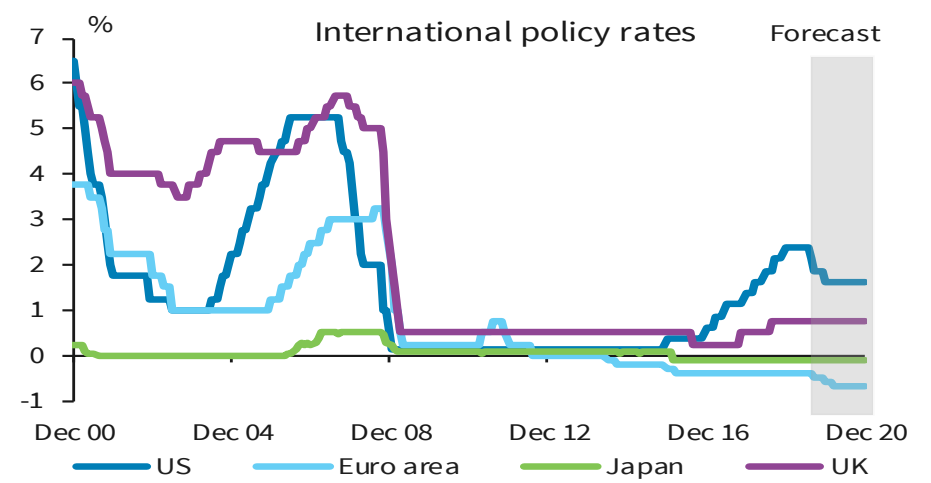
- Our global excess liquidity indicator, which is the spread between real money supply and IP growth, correlates well with the move in P/E multiples.
- The normalisation in central banks' balance sheets led to a reduction in excess liquidity in 2018. However, as central banks have turned much more dovish ytd, equity valuations re-rated along with the increase in excess money supply.

Reduced excess liquidity led P/E lower



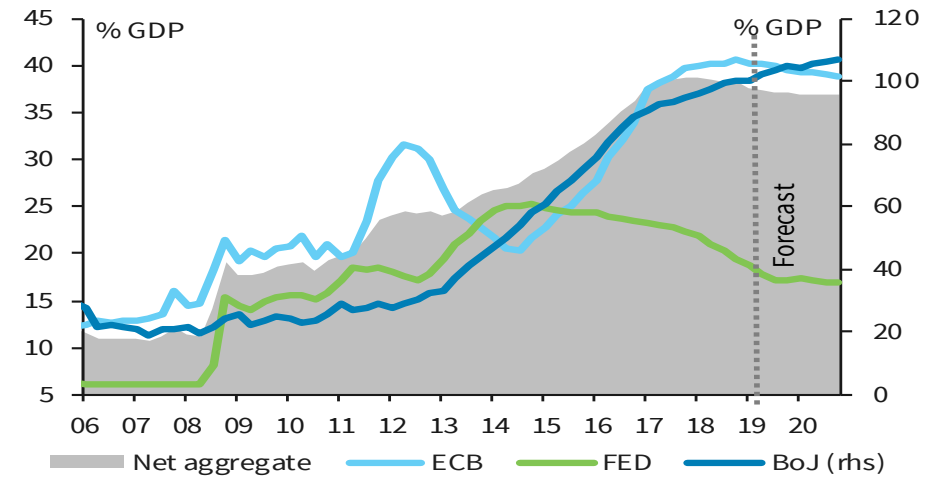
Source: Datastream, Barclays Research

Core central banks are on hold…



Source: Barclays Economics Research

…and balance sheets remain relatively stable

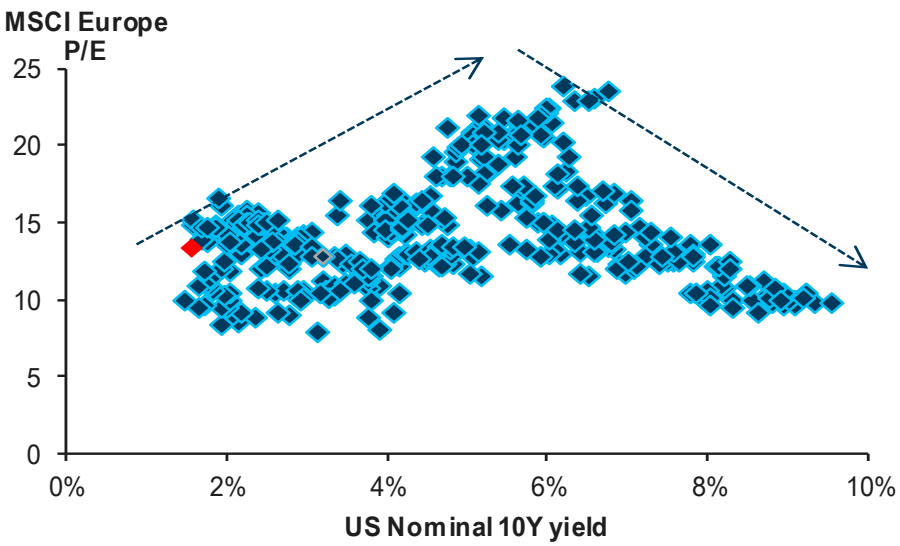


Source: Barclays Economics Research

Equities look attractively valued vs. expensive bonds…

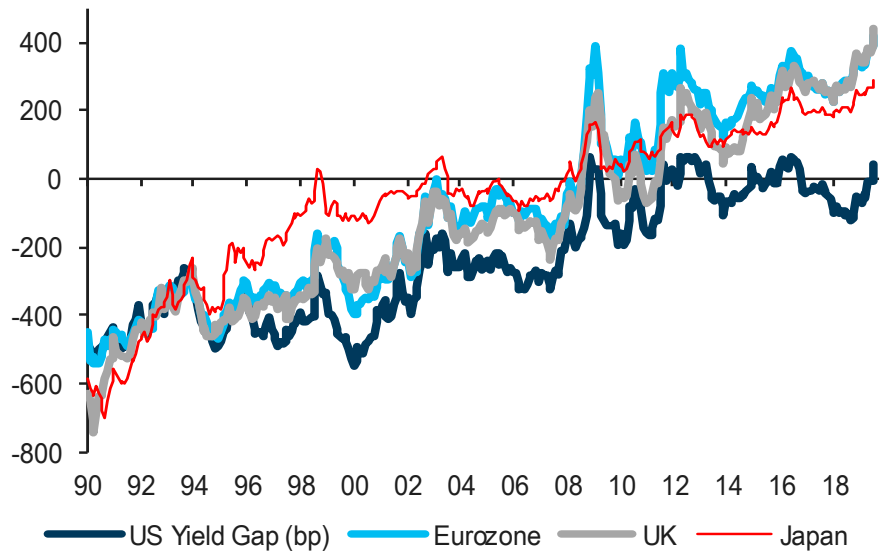
- The historical relationship between P/E and bond yields is not negative but positive, up to a point. Ytd though, P/Es have increased while bond yields moved much lower.
- Following the plunge in bond yields ytd, the yield differential with equities has increased in all the main regions.
- Global equities still have a significant valuation cushion to absorb a potential increase in yields.

Yields would need to increase a lot more in order to hurt equity valuations



Source: Datastream, red dot shows the current numbers

Relative to bonds, equities still look attractively valued

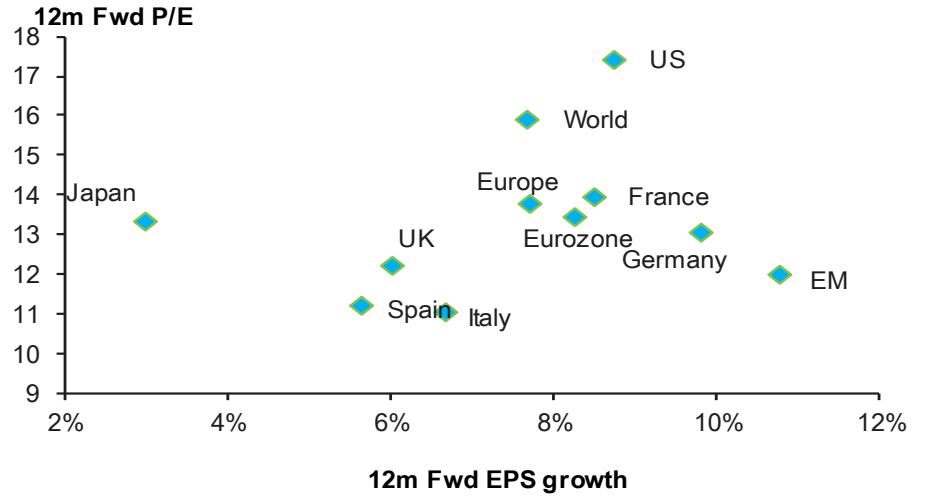


Source: Datastream

…but P/Es fundamentally move with EPS revisions

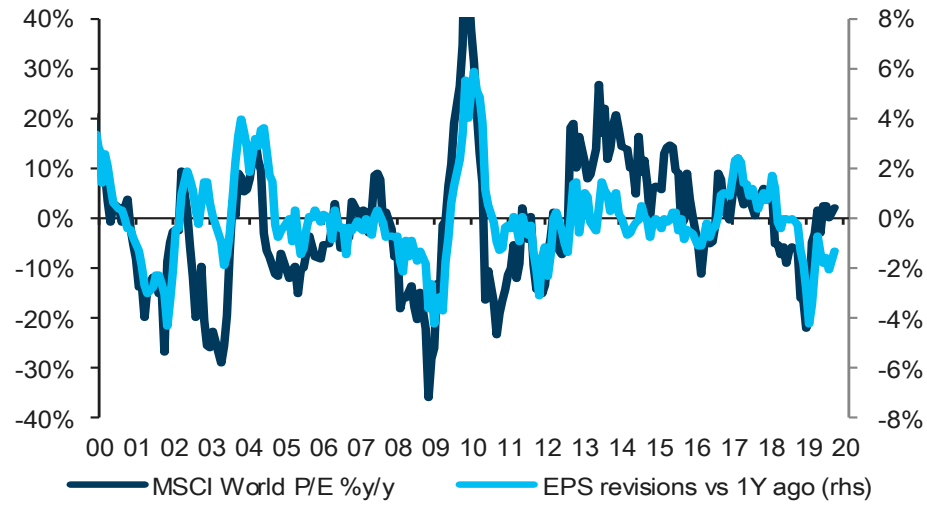
- Historically, there has been a strong positive correlation between the moves in P/E multiples and the change in EPS revisions.
- As P/E multiples are now back to fair value, a rebound in EPS revisions is required for P/E to expand sustainably.

P/Es are positively correlated to EPS growth



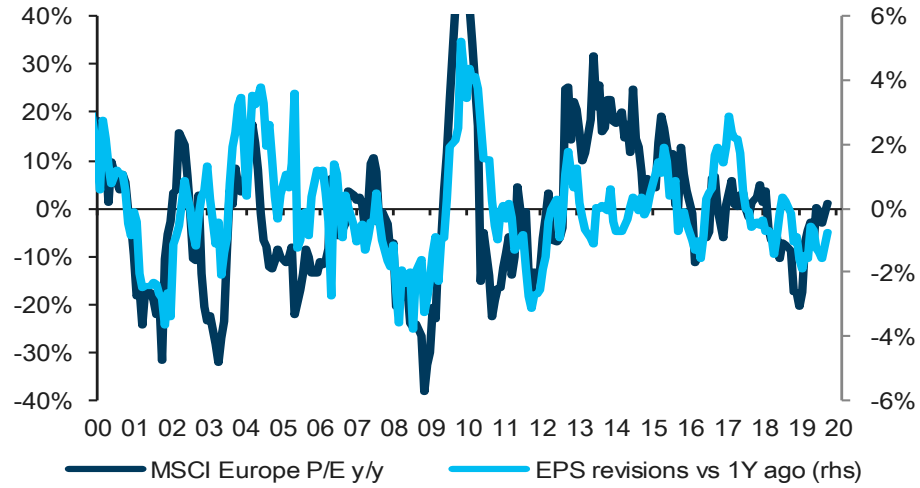
Source: Datastream, IBES

Change in P/E multiple and EPS revisions for MSCI World



Source: IBES

Change in P/E multiple and EPS revisions for MSCI Europe



Source: IBES

Our fair value models suggest market P/E's have little upside given current activity levels

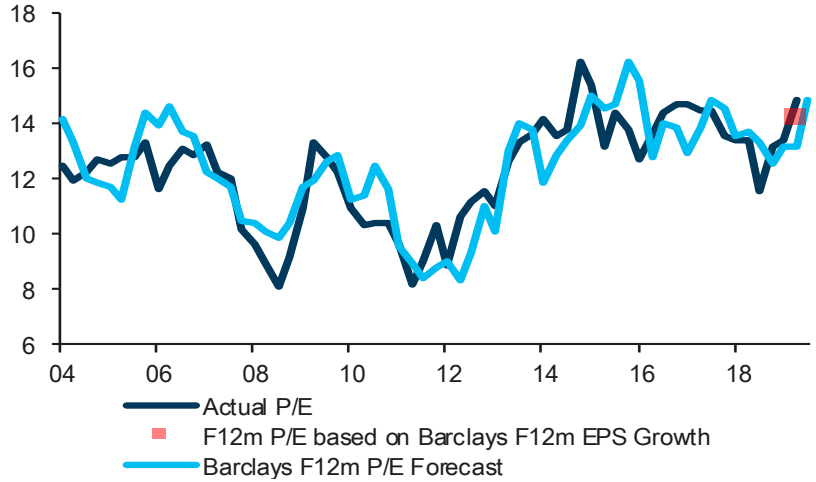
- Falling earnings and rising stock prices ytd have seen the market re-rate towards what look to be around fair value for the current/forecast economic environment.
- Broadly speaking, our economists' GDP growth forecasts imply PMI levels that justify current P/E levels for both Eurozone and UK, but leave little room for re-rating unless activity picks up.
- Real yield expansion is not expected to help either P/E higher.

P/E multiples s vs real yields and PMI New Orders

FTSE 100		-100	-50	0	50	100
PMI New Orders Level	45	11.7	12.2	12.7	13.2	13.7
	50	12.1	12.6	13.1	13.6	14.1
	55	12.5	12.9	13.4	13.9	14.4
	60	12.8	13.3	13.8	14.3	14.8
Euro Stoxx (SXXE)		**-100**	**-50**	**0**	**50**	**100**
PMI New Orders Level	45	14.2	14.6	15.1	15.6	16.0
	50	14.9	15.4	15.9	16.4	16.8
	55	15.7	16.2	16.7	17.1	17.6
	60	16.5	17.0	17.5	17.9	18.4

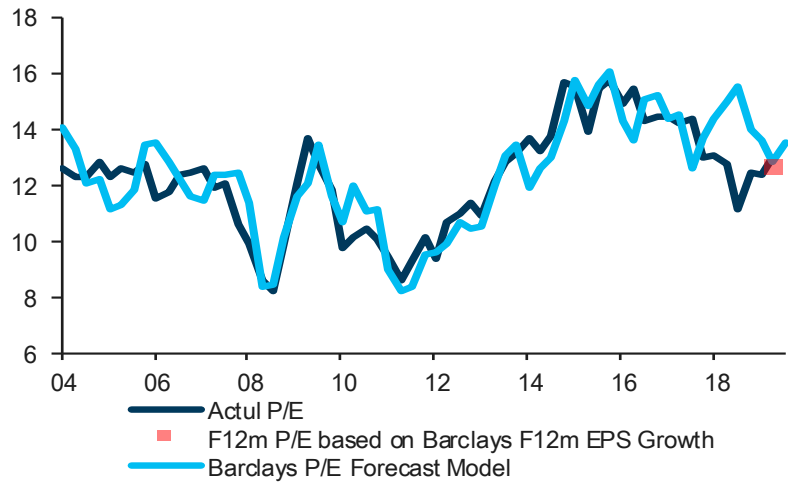
Source: IBES, Refinitiv, Bloomberg, Barclays Research

Euro Stoxx (SXXE) F12m P/E Forecast Model



Source: IBES, Refinitiv, Bloomberg, Barclays Research

FTSE 100 F12m P/E Forecast Model

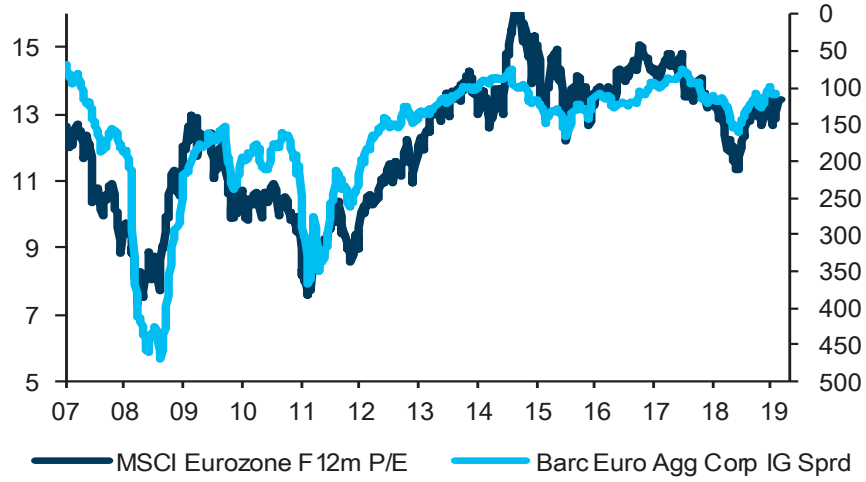


Source: IBES, Refinitiv, Bloomberg, Barclays Research

Credit markets are well behaved…

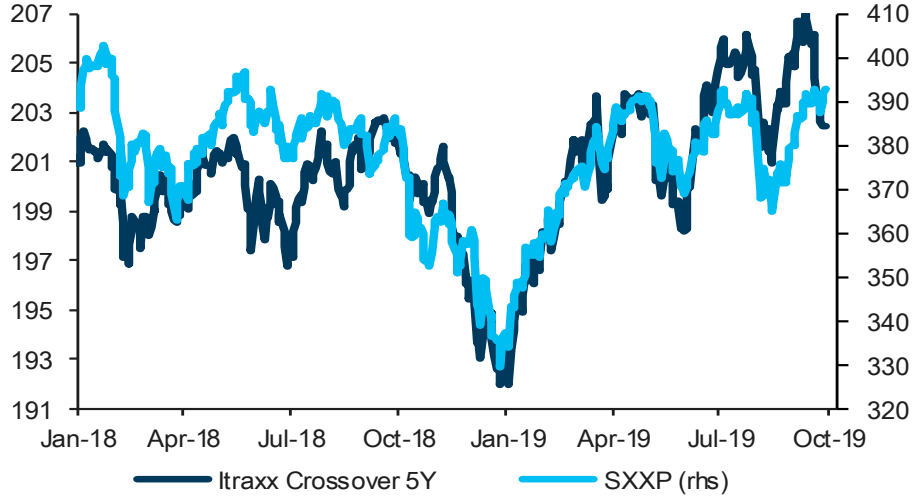
- The correlation between Equities and Credit is strongly positive. Many investors saw the spike in credit spreads as a red flag for equities in Q4, but both asset classes rallied in tandem this year.
- Credit fundamentals are not getting any better, but the corporate sector is generally in a good shape and debt affordability is elevated, as credit costs are low and EPS growth is slowing but not collapsing.
- As central banks are delivering more stimulus, the credit market should be supported. We note that most recently, credit rolled over in Europe.

P/E multiples move opposite to credit spreads



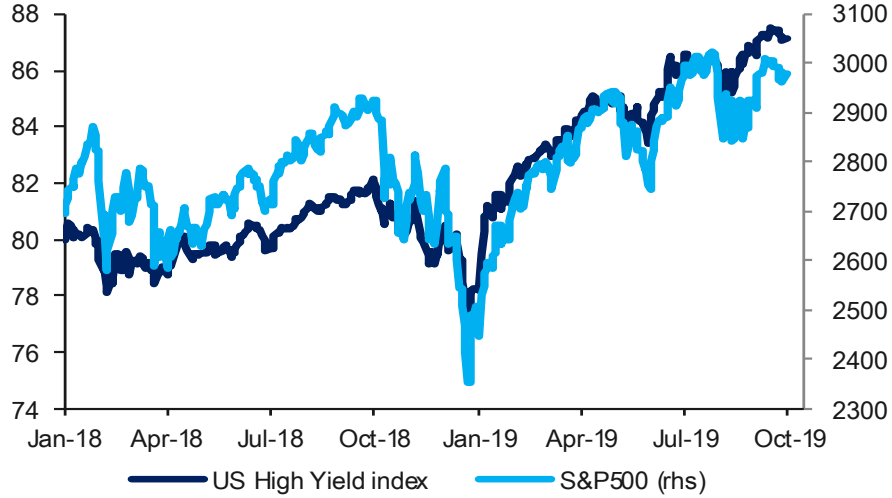
Source: Datastream, Bloomberg, IBES

Credit and equities move together in Europe…



Source: Bloomberg

...and in the US

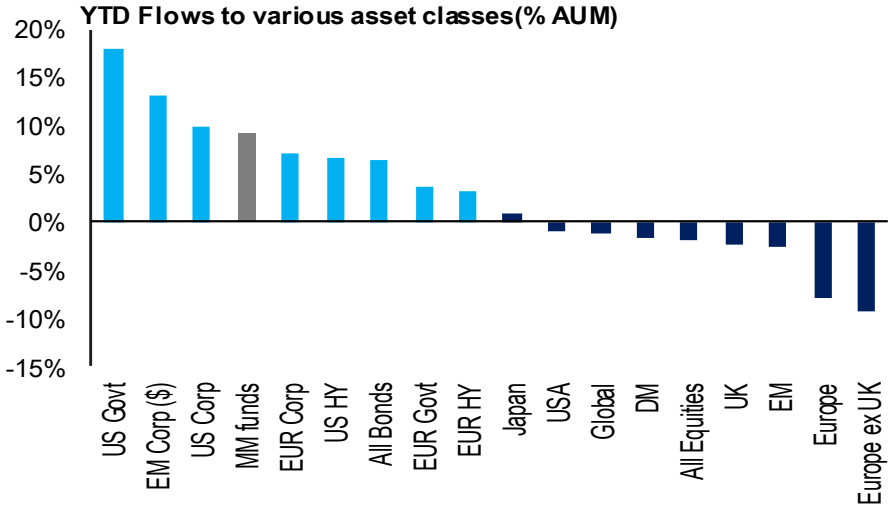


Source: Bloomberg

…the search for yield is in full play

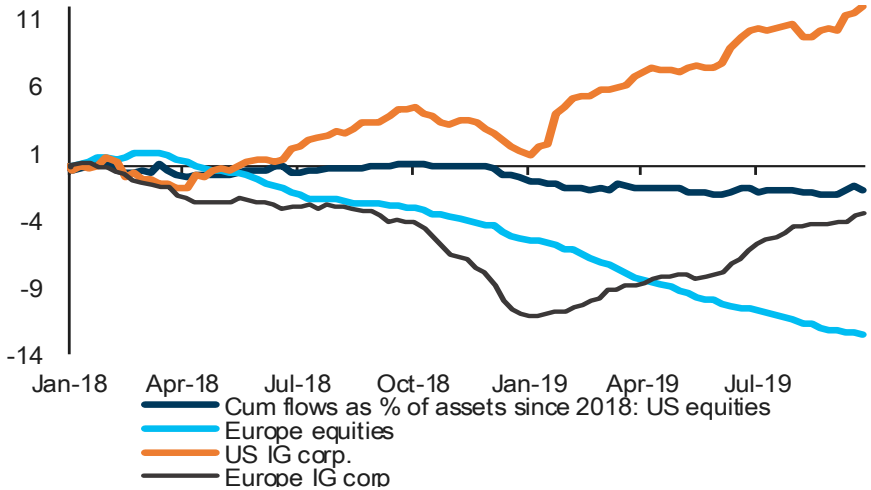
- As the Fed and ECB have turned to stimulus mode, corporate credit and EM fixed income are rallying.
- IG and HY credit funds have seen strong inflows recently in Europe and the US, as have EM hard-currency bonds.
- On the flipside, EM equities, which are more growth-sensitive, keep recording outflows.

Cash and credit are the big beneficiaries of flows recently as investors go scouting for safety and yield



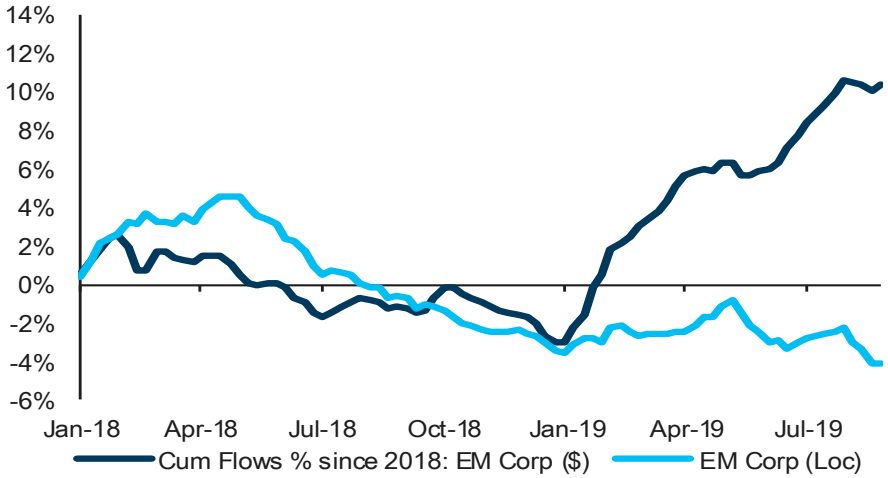
Source: EPFR, Barclays Research

IG credit and equity flows are diverging ytd in Europe and US



Source: EPFR, Barclays Research, Bloomberg

Hard currency EM bonds are seeing inflows

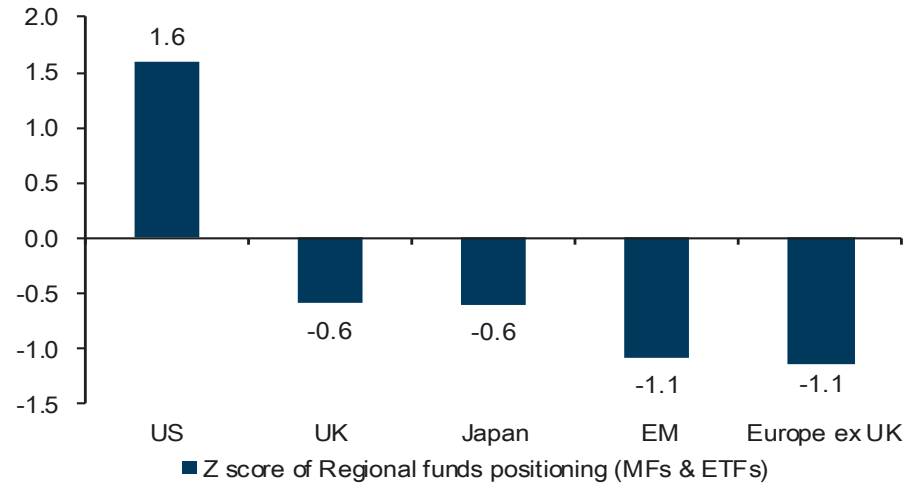


Source: EPFR, Barclays Research

Regional Allocation
1) MW Europe vs US - Europe is consensus UW…

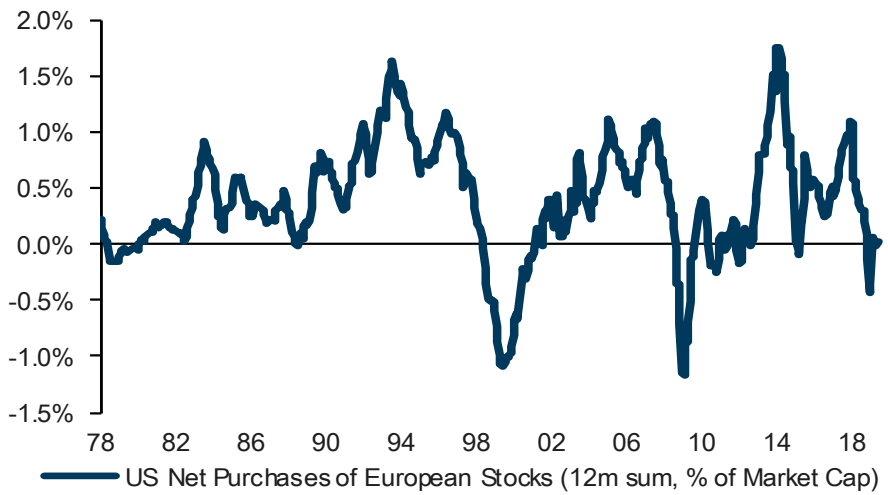
- Investor appetite for Europe is depressed and the region is a consensus UW.
- US investors have turned net sellers of European equities ytd, for the first time in three years.
- Outflows from European equities look somewhat exaggerated compared to fundamentals.

Europe ex UK positioning is materially underweight



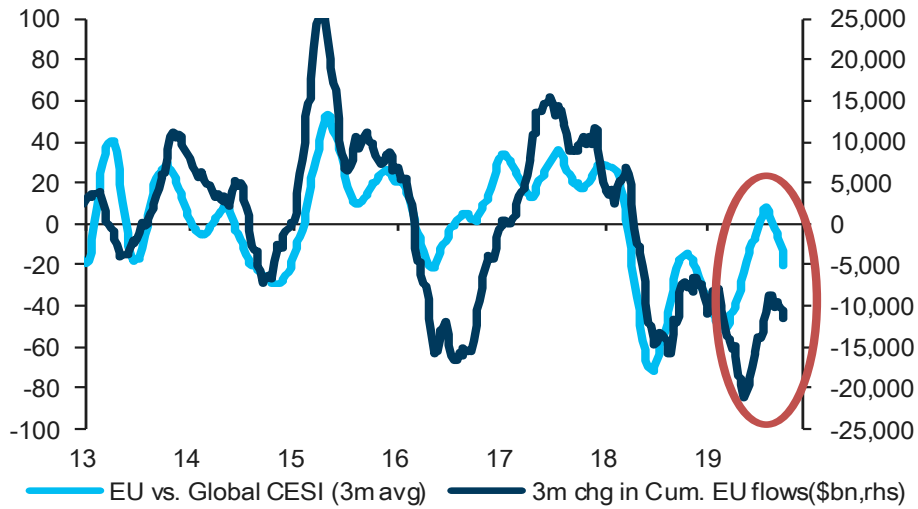
Source: EPFR, Bloomberg

US investors have turned net sellers of European equities



Source: TIC, Datastream

European equity flows look significant compared to fundamentals

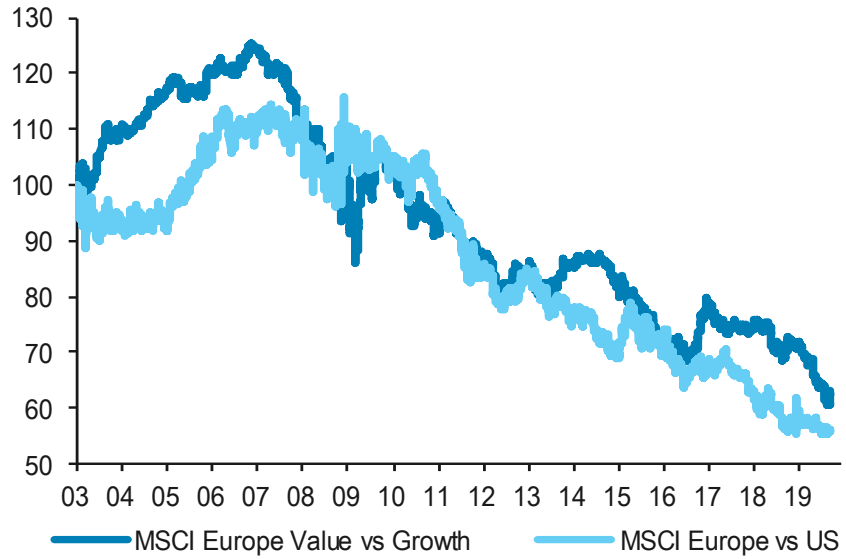


Source: EPFR, Bloomberg, Datastream

…but the region benefits from the rotation into Value

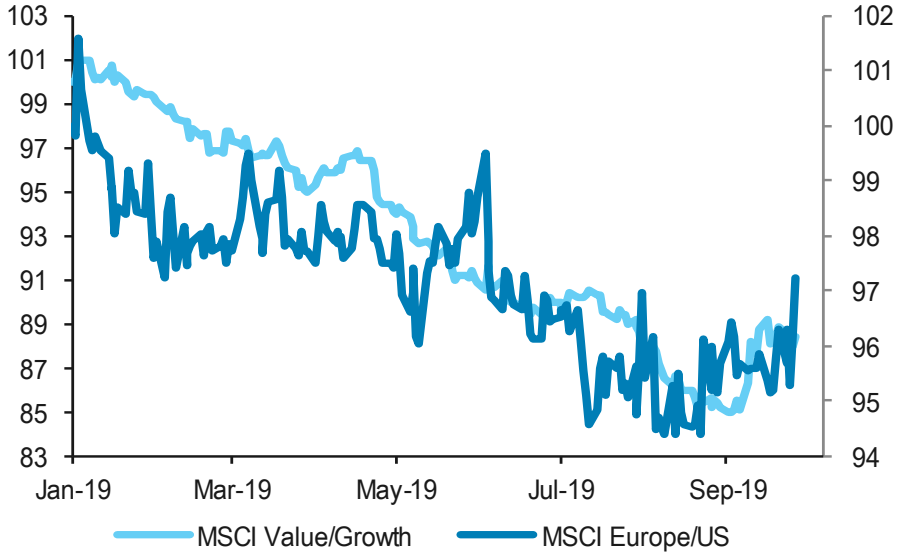
- The European equity market has a Value style bias compared to the US. The relative performance between the two regions closely tracks the style performance.
- As Value outperformed in the last cycle, Europe did relative to the US. However, with Growth driving the markets higher this cycle, Europe has underperformed in conjunction with Value.
- In the last few weeks though, we note that Europe marginally outperformed the US as market leadership reverted to Value.

Europe/US performance has closely moved with Value/Growth



Source: Datastream

Most recently, Europe outperformed US as Value rebounded

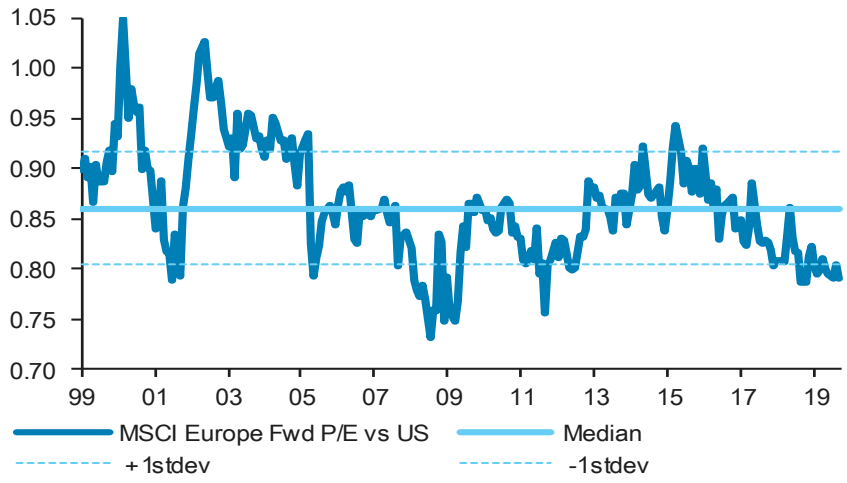


Source: Datastream

European valuations are attractive relative to the US…

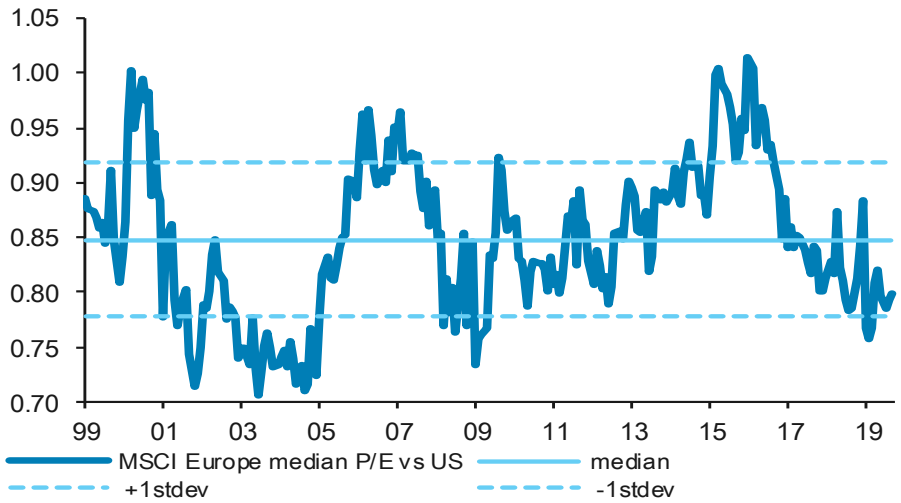
- European valuations have de-rated relative to US equities and are looking attractive in the historical context.
- Even adjusted for sector composition European P/E is on the cheap side of fair value relative to the US.

Europe/US P/E is close to the bottom of the range



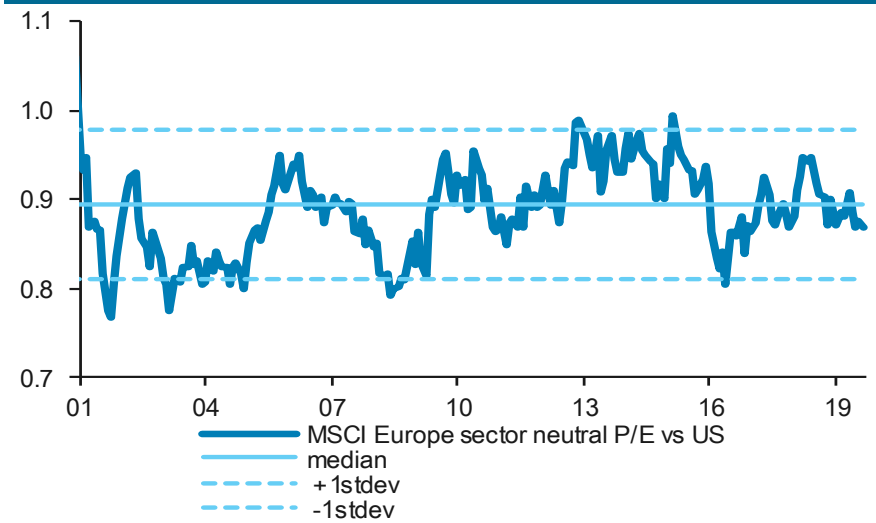
Source: IBES

The median P/E of Europe vs US is also depressed



Source: IBES, Barclays Research

Adjusted for sector composition, European P/E is just below historical relative

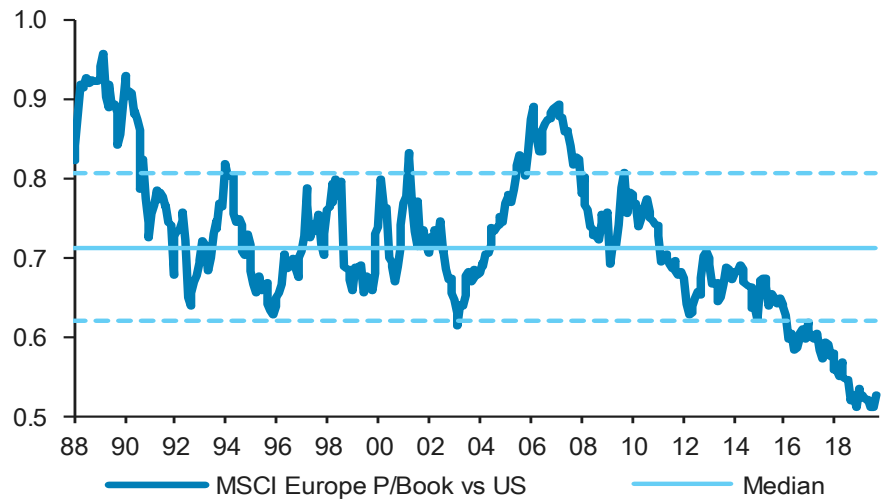


Source: IBES, Barclays Research

…but profitability is lower

- On P/Book metrics, the US is trading the most expensive of the main regions, which looks consistent with its higher-than-average ROE.
- On the flipside, Europe, EM and Japanese equities are all trading at a discount to their 20-year median multiple.

Europe P/B relative to the US is at 30-year lows



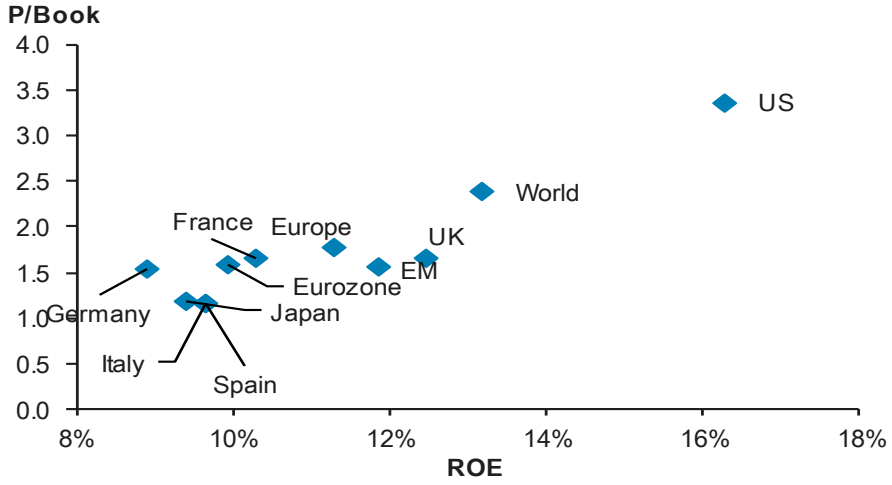
Source: Datastream

Regional P/Book in the historical context

	Current	10Y Median	20Y Median	Current vs 10Y Median	Current vs 20Y Median
MSCI World	2.4	2.1	2.3	13%	4%
US	**3.4**	**2.7**	**2.9**	**24%**	**18%**
Europe	**1.8**	**1.7**	**1.8**	**4%**	**-3%**
UK	1.7	1.8	1.9	-7%	-13%
Eurozone	1.6	1.5	1.7	6%	-4%
France	1.7	1.4	1.6	15%	1%
Germany	1.5	1.6	1.7	-2%	-8%
Italy	1.2	1.0	1.2	18%	-1%
Spain	1.2	1.3	1.6	-12%	-25%
Japan	**1.2**	**1.3**	**1.4**	**-5%**	**-14%**
EM	**1.6**	**1.6**	**1.7**	**-2%**	**-8%**
Brazil	2.1	1.5	1.6	35%	35%
Russia	0.9	0.8	1.1	9%	-17%
India	2.6	3.1	3.1	-16%	-17%
China	1.6	1.7	1.8	-1%	-9%

Source: Datastream

Regional P/Book vs ROE

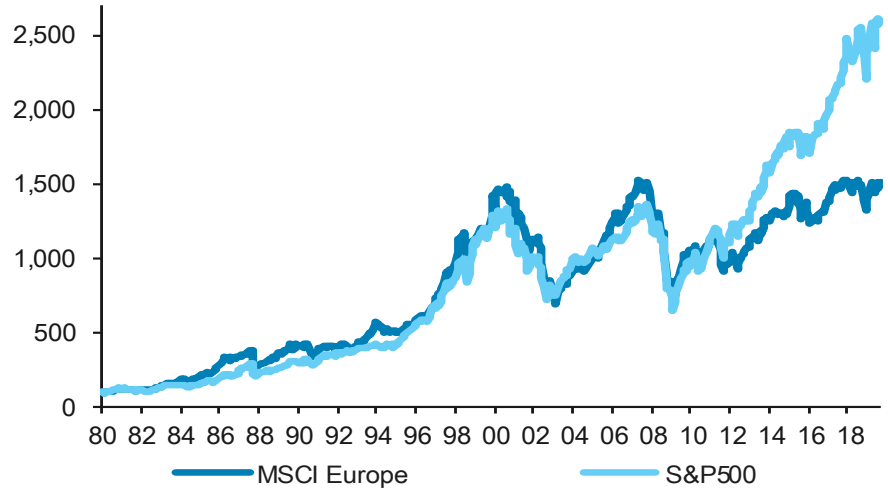


Source: Datastream

All about earnings - a catalyst for a sustainable outperformance of Europe is missing…

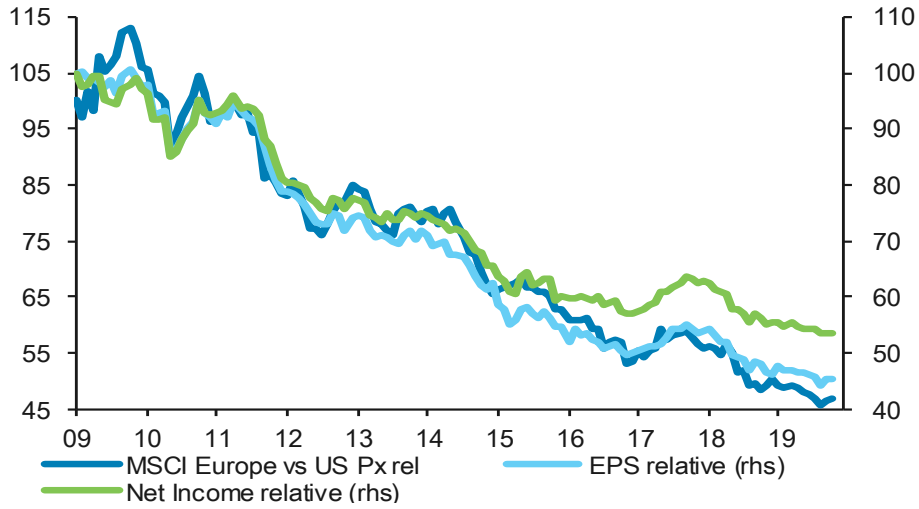
- Europe has underperformed the US all the way since 2011. Ytd though, it is holding up relatively better.
- US outperformance during the last decade has largely been driven by relative earnings.
- The EPS growth differential between US and Europe is expected to narrow from high teens in 2018 to low single digits in 2019.

Europe has underperformed since 2011



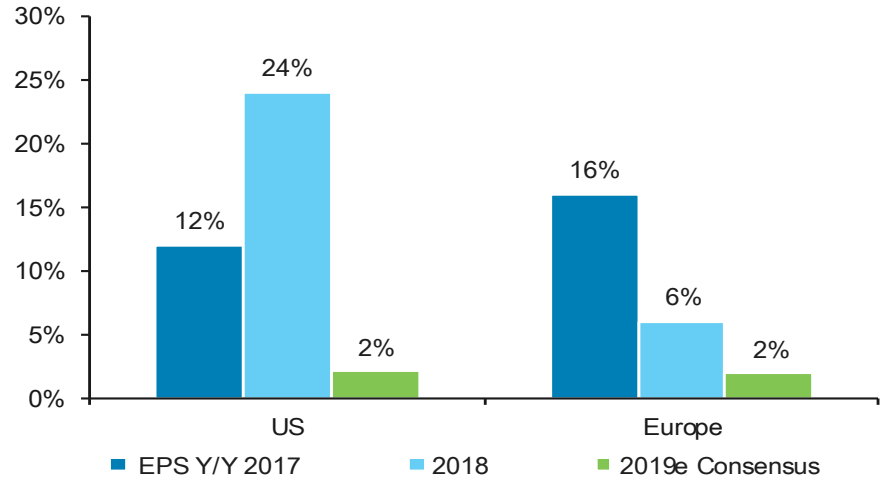
Source: Datastream, re-based to 100 in Jan-80

Europe's underperformance has been largely due to earnings



Source: IBES, Refinitiv, Barclays Research

US-Europe EPS growth differential will narrow in 2019

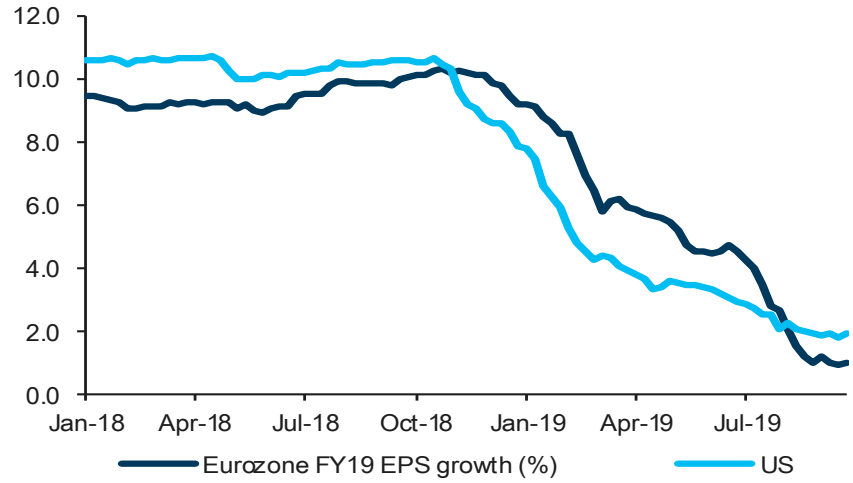


Source: Datastream, IBES, Bloomberg

…but the relative EPS growth of Europe remains stable versus US

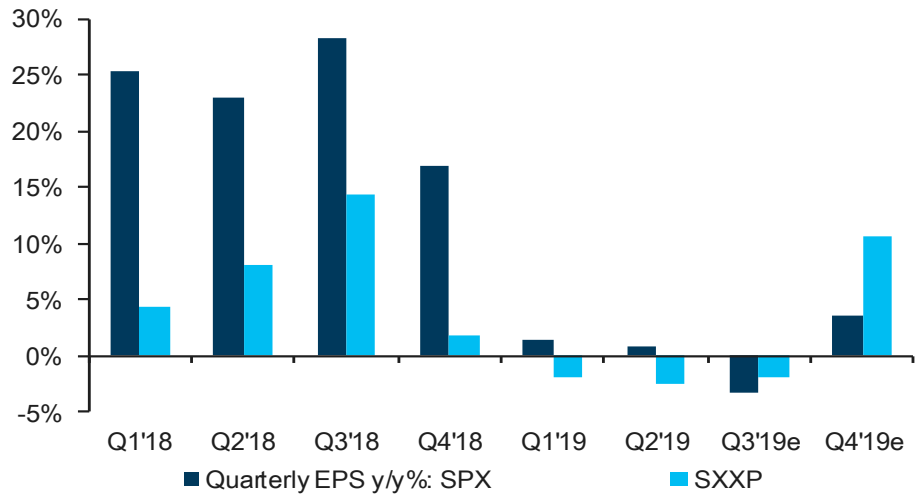
- European earnings undershot the US ones substantially in 2018, as the latter were boosted by the corporate tax cut.
- We are cautious on European earnings for 2019, looking for almost no growth, but the base effects are turning less favorable for US earnings this year.
- Further, the relative EPS momentum of Europe has stabilized relative to US recently.

Europe '19 EPS estimates are declining in line with US



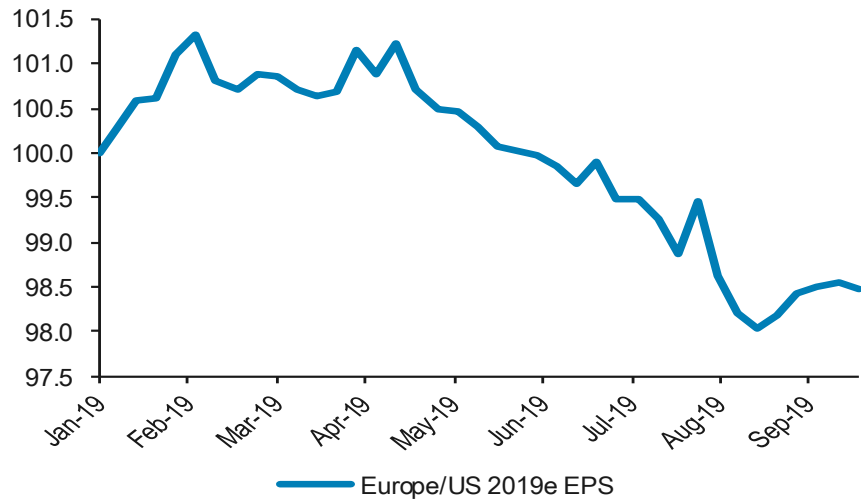
Source: IBES, Barclays Research

The EPS growth differential b/w US and Europe is closing



Source: Refinitiv

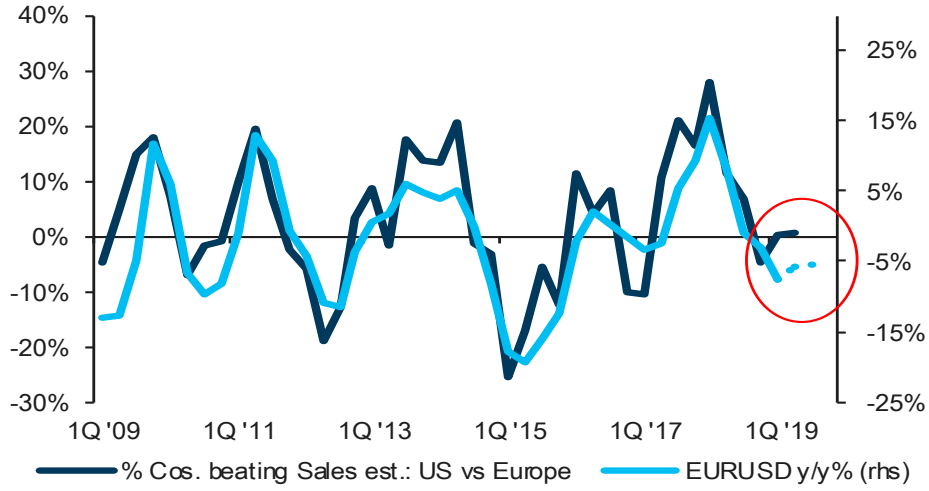
Europe EPS relative to US is stabilising



Source: IBES

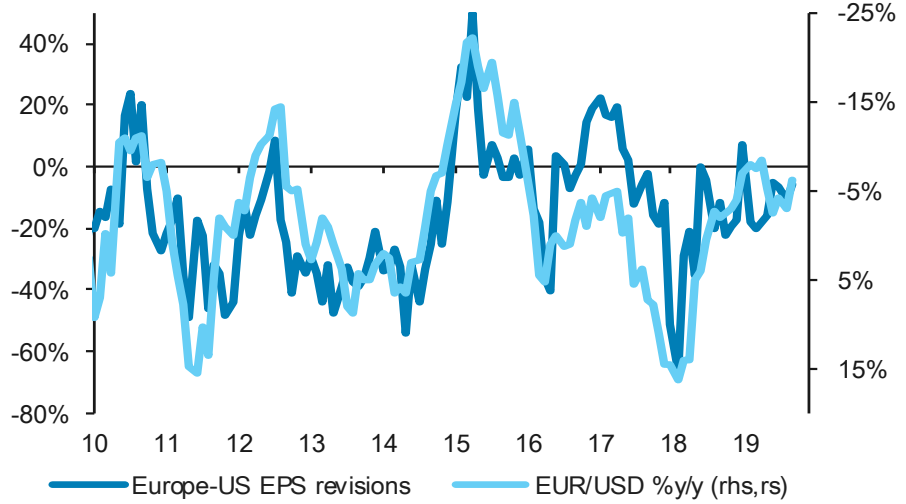
A weaker euro is a relative tailwind for European earnings

% Quarterly sales beats in US/Europe and EUR/USD



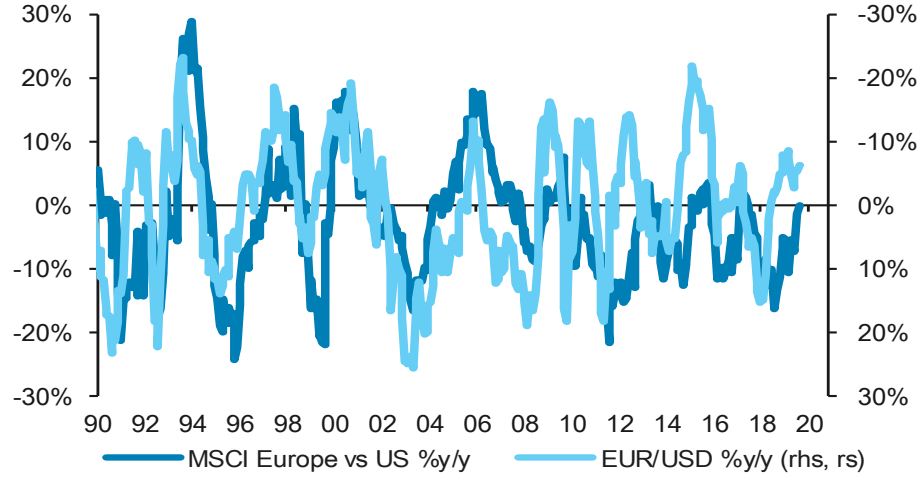
Source: Bloomberg, Barclays Research, dotted line uses spot EUR/USD until year-end

The weaker euro has helped the relative EPS revisions of Europe vs US



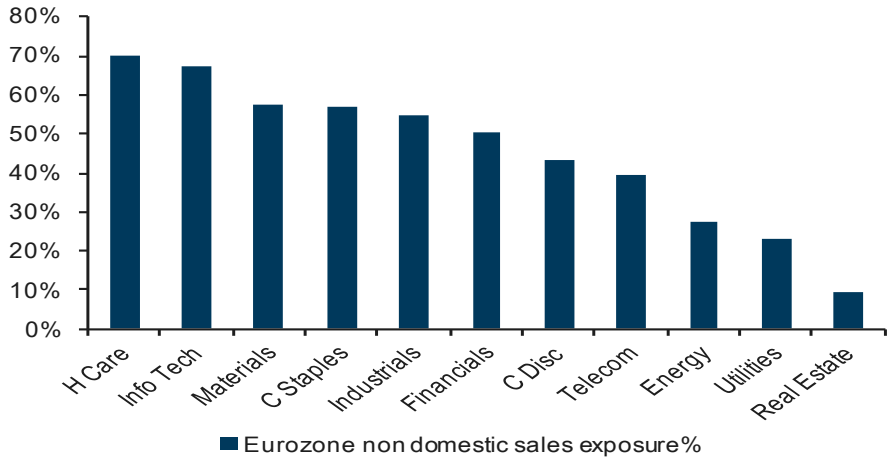
Source: Datastream

A weaker Euro should help European equities



Source: Datastream

Eurozone sectors' non-domestic revenues exposure

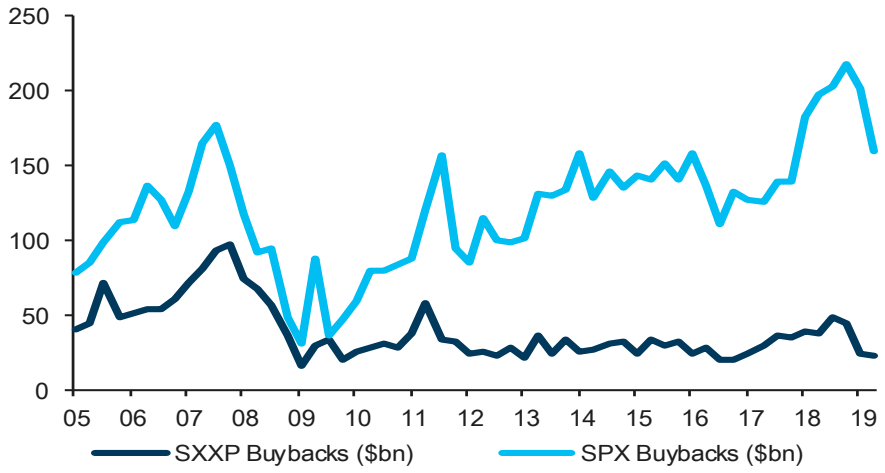


Source: Bloomberg, Worldscope

Buybacks and Tech have been key supports for US equities during this cycle

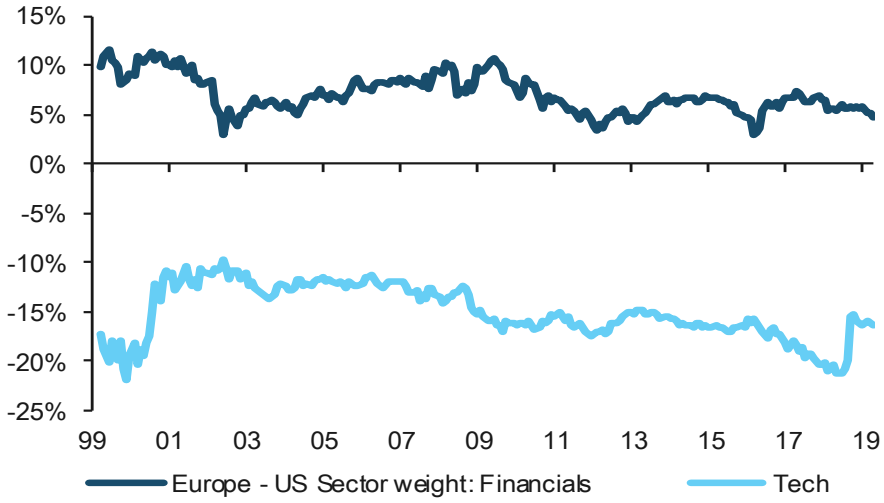
- Europe is somewhat of an "old economy" market dominated by Financials, Industrials, Materials and Staples, while Tech weights a mere 6% of the market cap, about the same as 15 years ago.
- In contrast, the weight of the Tech sector in the US index doubled between 2004-2018 (including FAANG stocks). Even after MSCI realignment, the sector still is 22% of US market cap.
- US buybacks were particularly strong in 2018 thanks to the boost from cash repatriation and corporate tax cuts, but should moderate in 2019. Europe might thus be less disadvantaged on this front.

Mind the gap between US and European buybacks



Source: Bloomberg, Barclays Research

Tech is 22% of US market cap… but only 6% of Europe



Source: Datastream. Note: US tech drop in Dec 2018 due to MSCI sector realignment

MSCI Europe and US sector composition and ROEs

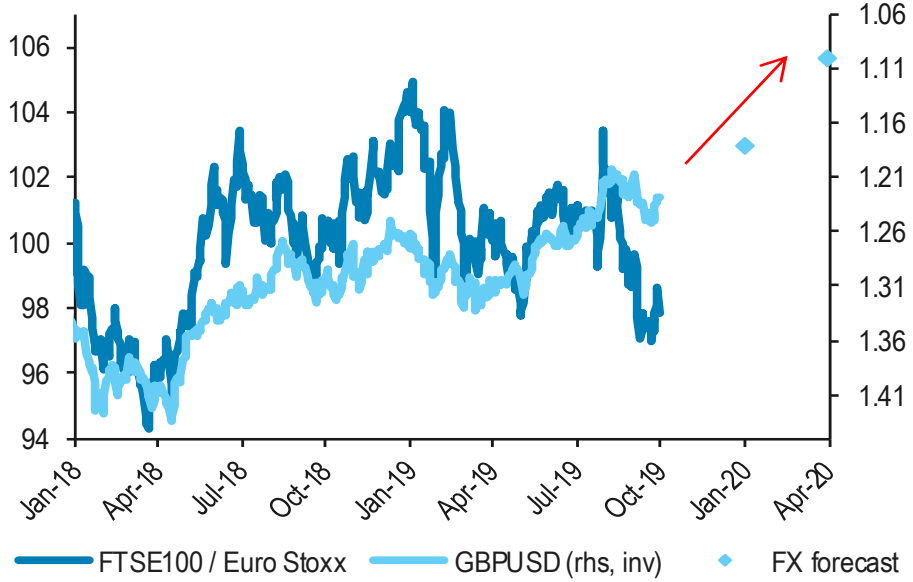
	Europe		US		Europe vs US	
	Weight	ROE	Weight	ROE	Weight	ROE
Market	100.0%	11.3%	100.0%	16.5%	0%	-5%
Energy	8%	11%	5%	9%	3%	2%
Materials	7%	13%	3%	12%	5%	1%
Industrials	13%	16%	9%	24%	4%	-8%
Discretionary	10%	14%	10%	32%	-1%	-17%
Staples	15%	16%	7%	27%	8%	-11%
Healthcare	13%	19%	14%	18%	0%	0%
Financials	18%	8%	13%	11%	5%	-3%
IT	6%	12%	22%	32%	-16%	-20%
Telecoms	5%	9%	10%	15%	-6%	-6%
Utilities	4%	11%	3%	9%	1%	2%
Real Estate	1%	6%	3%	9%	-2%	-3%

Source: Bloomberg, Datastream

2) OW UK vs Eurozone, FX-hedged

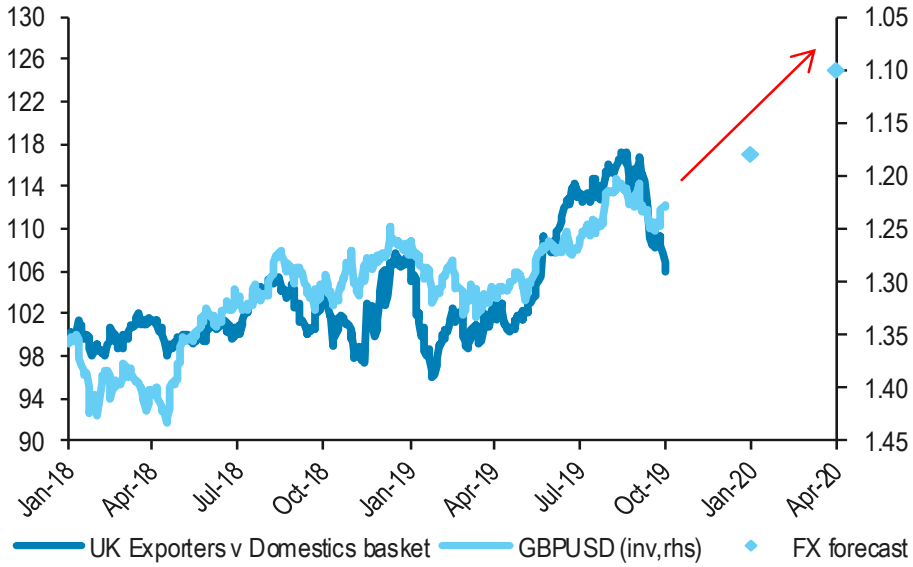
- Brexit uncertainty comes with a silver lining for UK equities, in the form of weaker GBP. This should continue to help the relative performance of UK vs Eurozone.
- It should also support Exporter vs Domestic plays. The relative performance of our Exp/Dom baskets remains coupled to GBP.

Considering our Jan'20 No Deal forecasts, the UK could be down in absolute terms, but outperform Eurozone…



Source: Barclays Research, Refinitiv Datastream, Barclays FX Strategy.

… and Exporters could outperform Domestics by mid-single digits, too

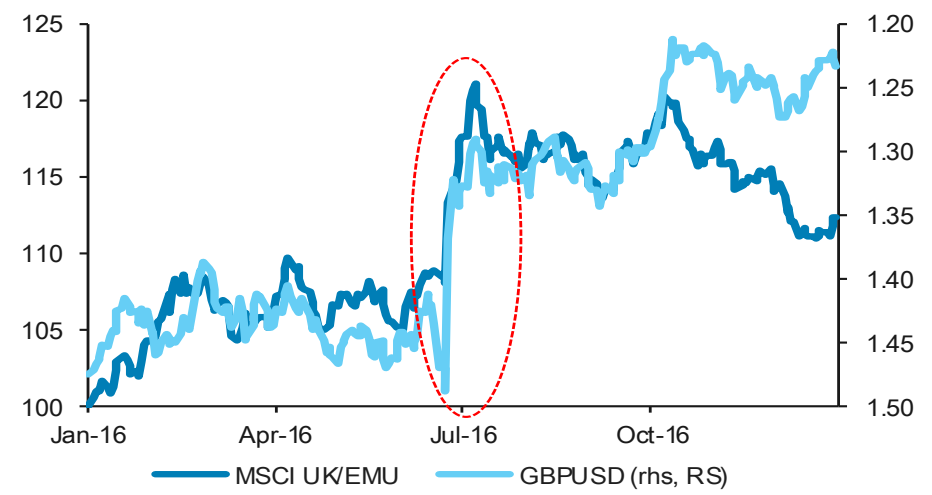


Source: Barclays Research, Refinitiv Datastream, Barclays FX Strategy.

GBP direction matters for the relative performance of UK equities

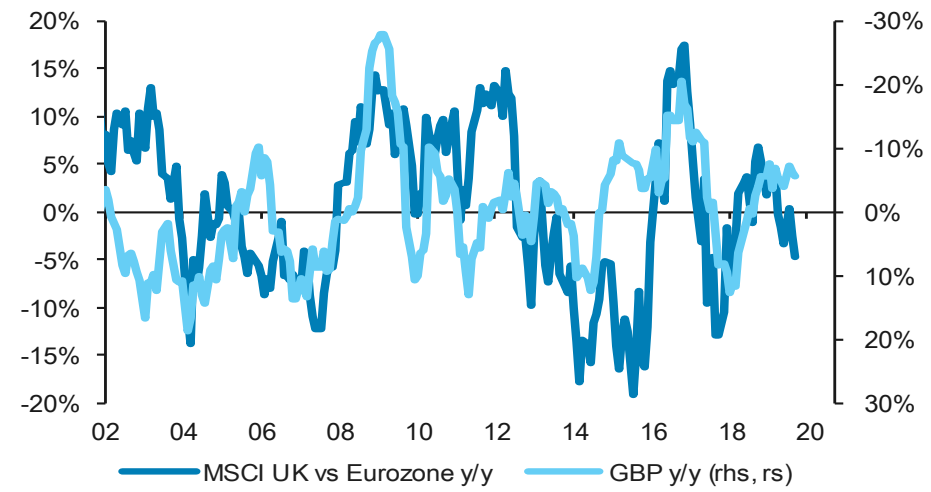
- Large-cap UK indices derive +70% of revenues from overseas, so their earnings and performance are highly dependent on the direction of GBP. UK relative performance is negatively correlated to GBP, which provided a cushion to UK equities in 2016.
- Similarly, the relative performance of Domestics vs Exporters, evident through either FTSE250/100 or our Domestics basket (BCEUUKDM) vs Exporters (BCEUUKEX).
- The FTSE250/100 trade has dislocated from GBP recently, likely due to the broad-based August risk-off, which particularly hurt FTSE100 due to its high commodity, financials, and EM exposure.

The fall in GBP after the EU referendum provided a cushion to UK equities



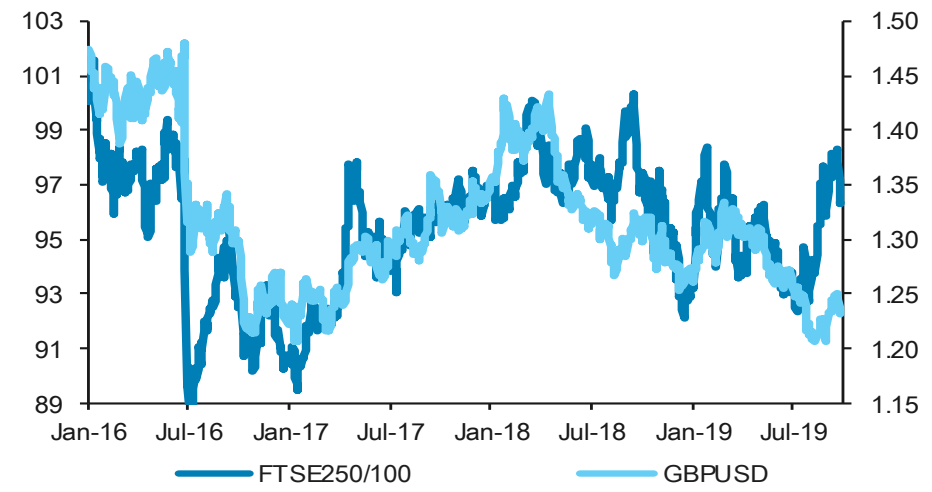
Source: Refinitiv Datastream, Bloomberg,

UK relative performance is negatively correlated to GBP…



Source: Barclays Research, Bloomberg, Refinitiv Datastream.

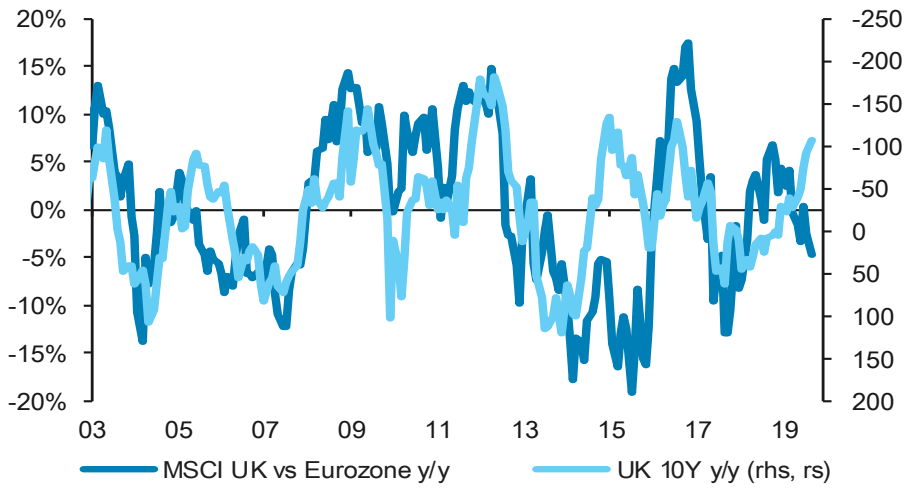
…as is the rel, perf. of Domestics / Exporters



Source: Barclays Research, Refinitiv Datastream.

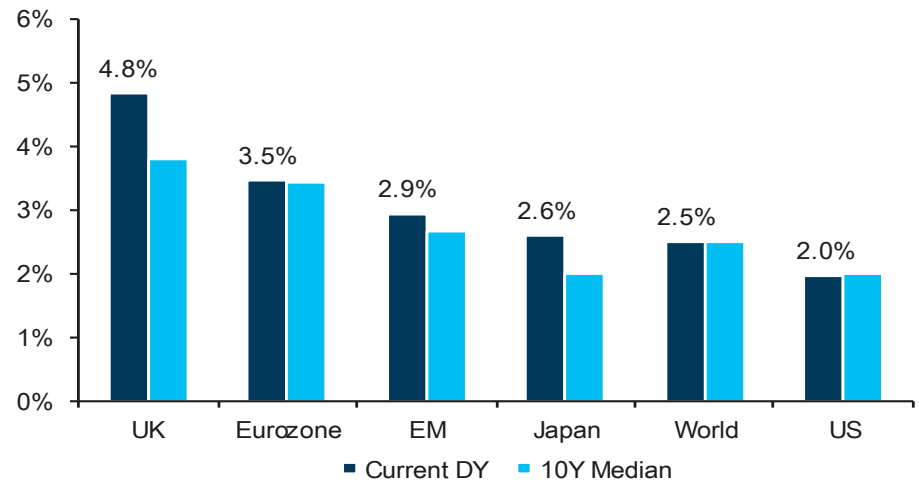
UK is biased to Defensives and Value

UK equities move in the opposite direction to bond yields



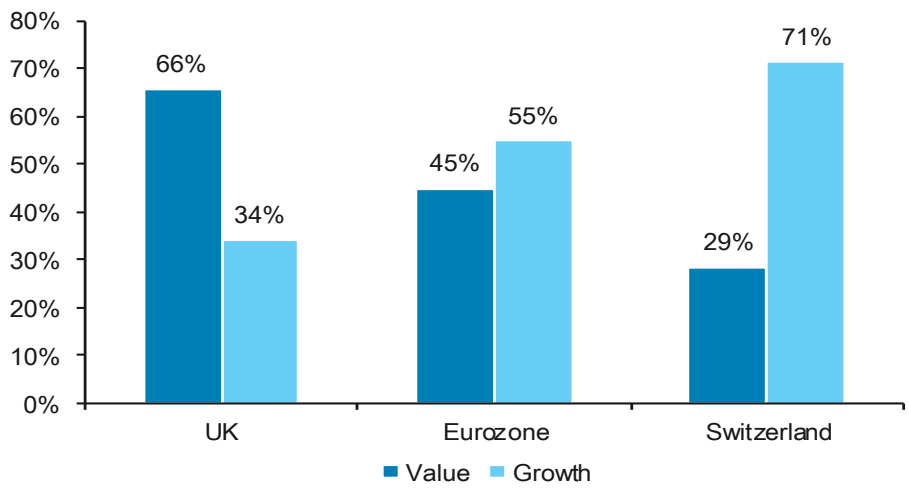
Source: Datastream

UK offers one of the highest dividend yield within Europe



Source: Datastream

UK is Value, Eurozone and Switzerland are Growth



Source: Datastream

MSCI UK has an Energy and Defensive bias

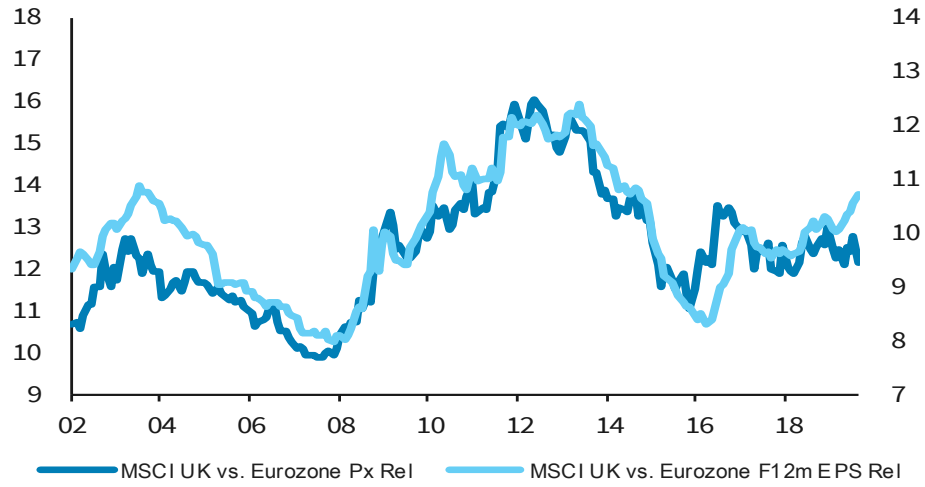
	MSCI UK	MSCI Eurozone	MSCI World
Energy	**17%**	**5%**	**5%**
Materials	9%	7%	4%
Industrials	10%	15%	11%
Discretionary	6%	14%	11%
Staples	17%	11%	9%
HealthCare	10%	7%	12%
Financials	20%	17%	16%
IT	1%	10%	17%
Telecoms	5%	5%	8%
Utilities	3%	7%	3%
Real Estate	1%	2%	3%
Cyclicals	27%	46%	43%
Defensives	31%	27%	28%
Cyc-Def	**-4%**	**19%**	**15%**

Source: Datastream

MSCI UK vs. Eurozone valuations are not demanding

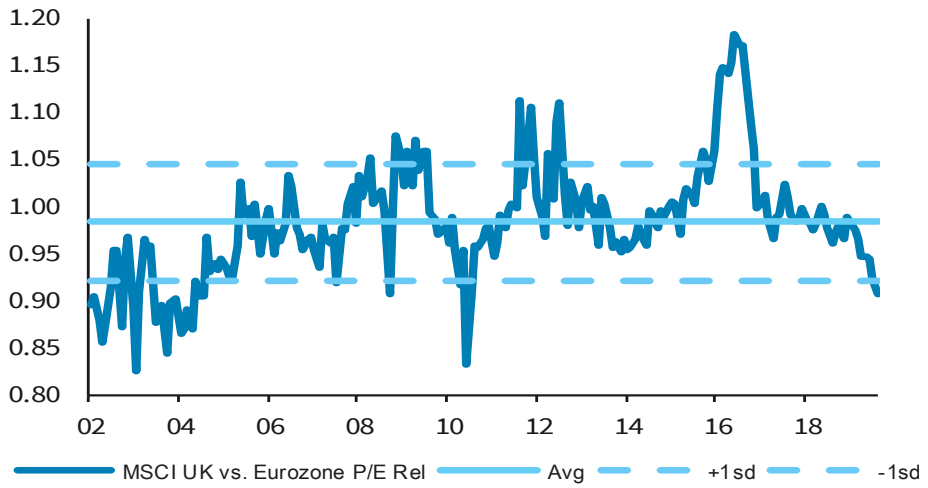
- The valuation argument to own UK vs Europe has recently become more attractive, with P/E Relative now below the long-run average, and P/B Relative near -1sd cheap. UK equities are starting to look cheap vs. Eurozone equities.
- This happened as UK price has underperformed, despite more resilient earnings.
- We find relative earnings momentum is also supportive – UK earnings estimates stopped falling back in March, whereas those for the Eurozone are still falling.

Price & EPS relative



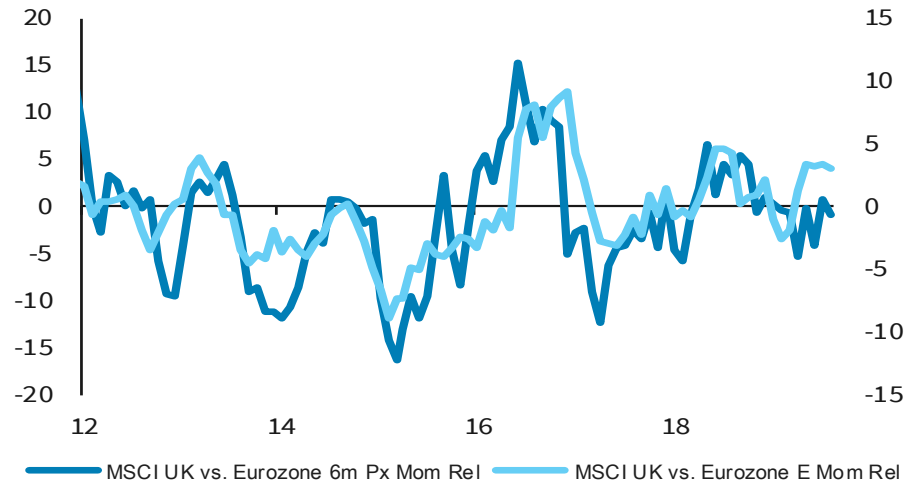
Source: MSCI, IBES, Refinitiv, Barclays Research

UK/Eurozone P/E relative is outright cheap



Source: MSCI, IBES, Refinitiv, Barclays Research

Relative Earnings Momentum has recently ticked up

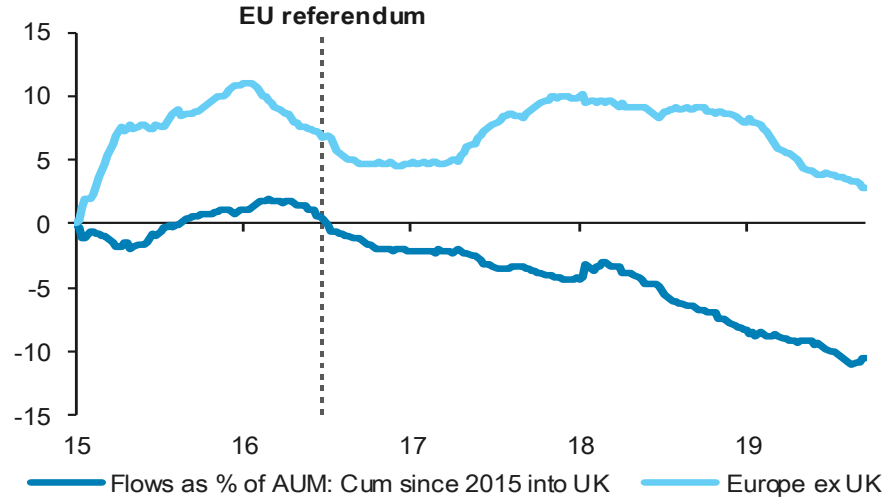


Source: MSCI, IBES, Refinitiv, Barclays Research

The moving probability of hard Brexit matters for UK asset prices

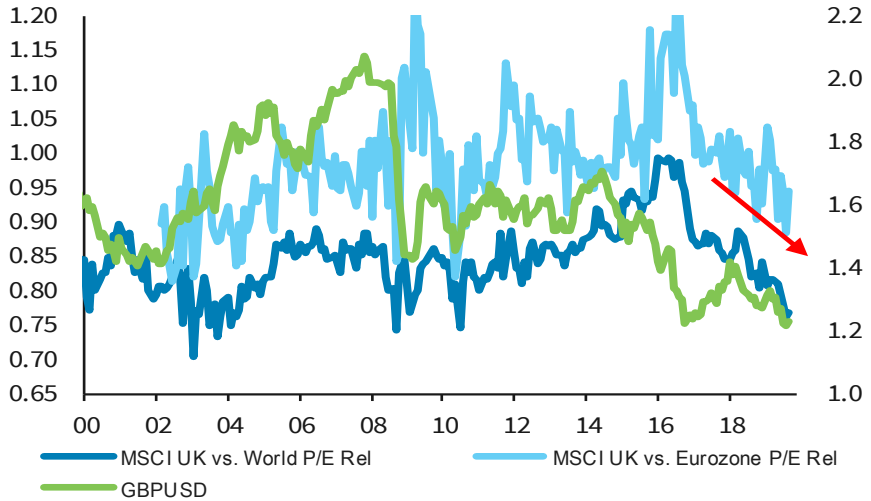
- UK and Eurozone equities have been reflecting rising Brexit uncertainty for some time now.
- Continuous outflows since the 2016 referendum suggest UK & Eurozone stocks have become under-owned in global portfolios. Likewise, UK valuations have de-rated significantly vs global peers, with UK P/E relative near historical lows at present. These factors have accelerated as No Deal looks more likely.
- Betting odds on No Deal in 2019 have moderated to c.20% with recent legislative changes. We find FX moves closely with the IP, and GBP strengthened as IP fell – however, a No Deal in 2020 remains a distinct possibility, keeping GBP rangebound for now.

UK equities have seen continuous outflows since June'16



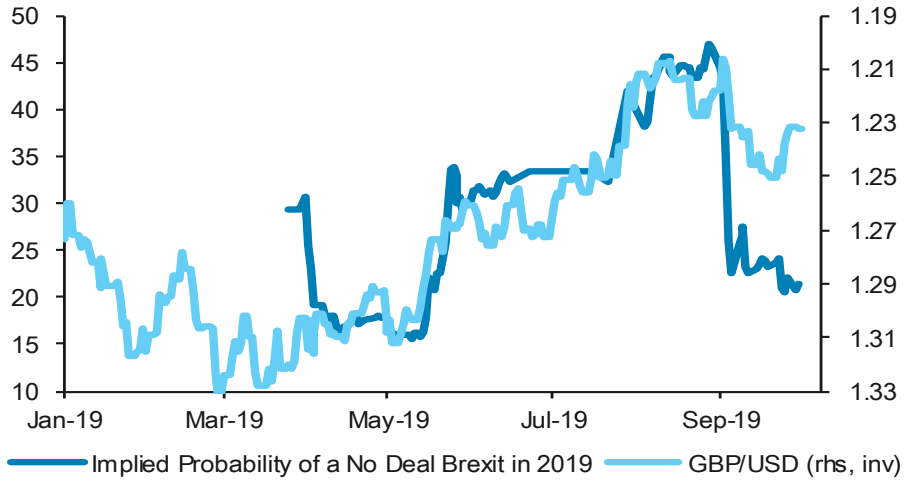
Source: EPFR, Barclays Research.

UK P/E ratio has de-rated compared to other regions



Source: Refinitiv Datastream.

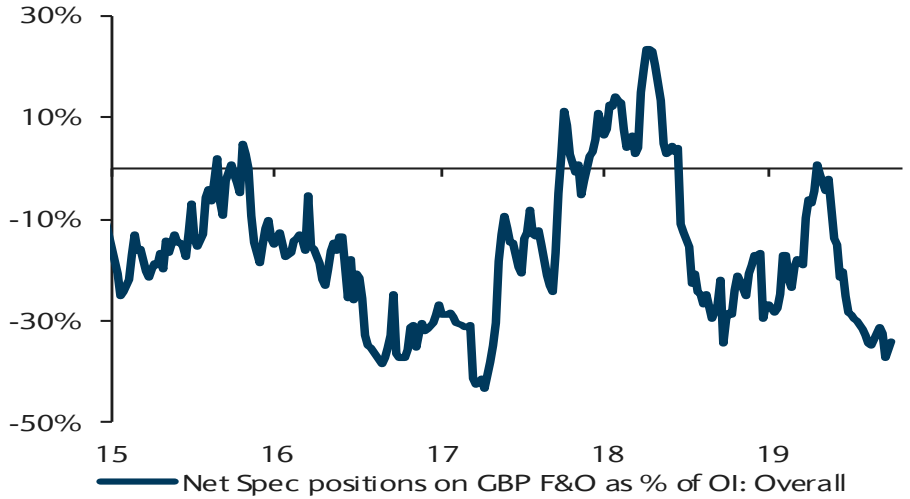
Lower implied probability of No Deal in 2019 being reflected in stronger GBP – although 2020 risks remain



Source: Barclays Research, Bloomberg, Oddschecker, Refinitiv Datastream.

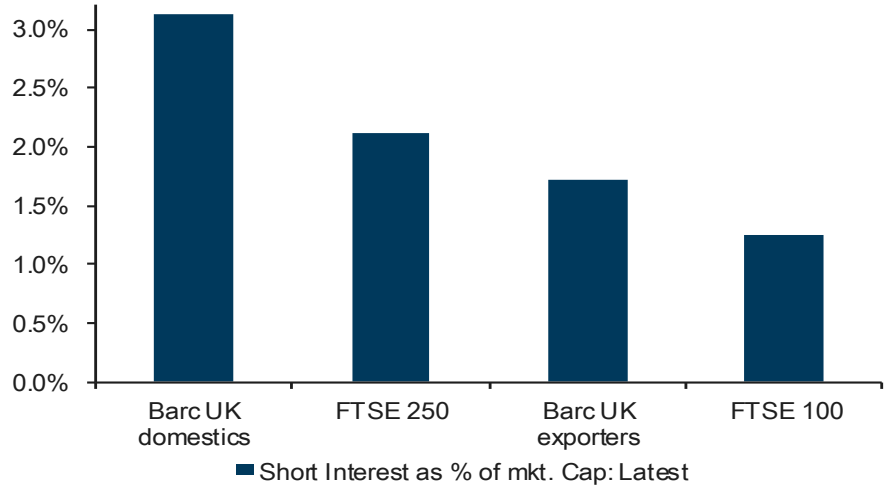
Domestic UK exposure is unloved

GBP speculative positioning has turned short again



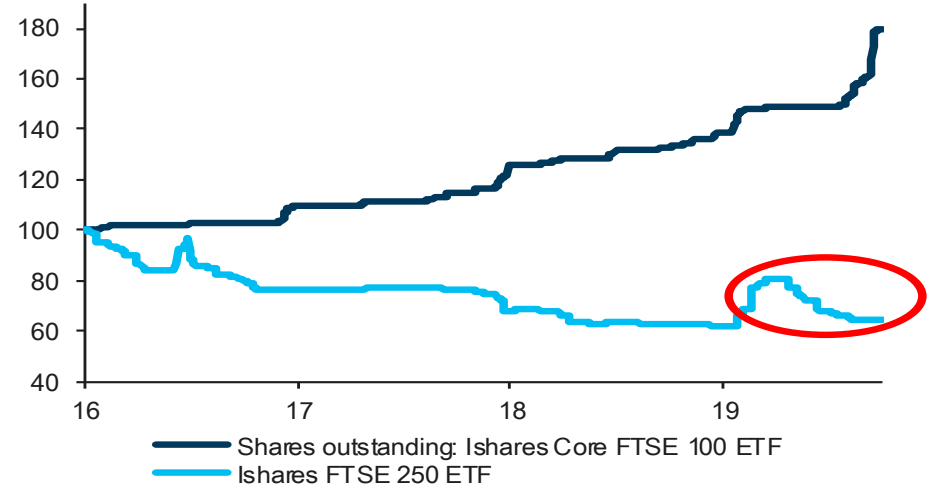
Source: Bloomberg, CFTC

Short interest is higher for domestic plays than for exporters



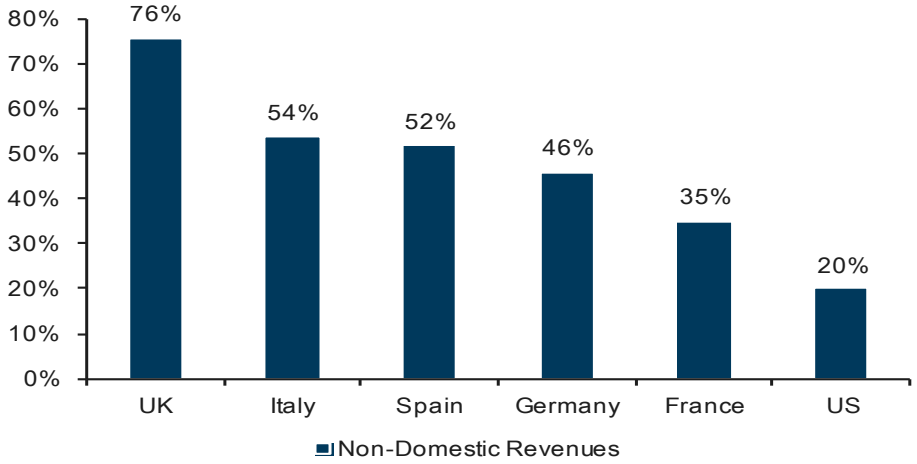
Source: Bloomberg, Markit, Barclays Research

FTSE 250 ETFs have seen redemptions recently



Source: Bloomberg

The UK has more foreign revenue exposure than continental Europe

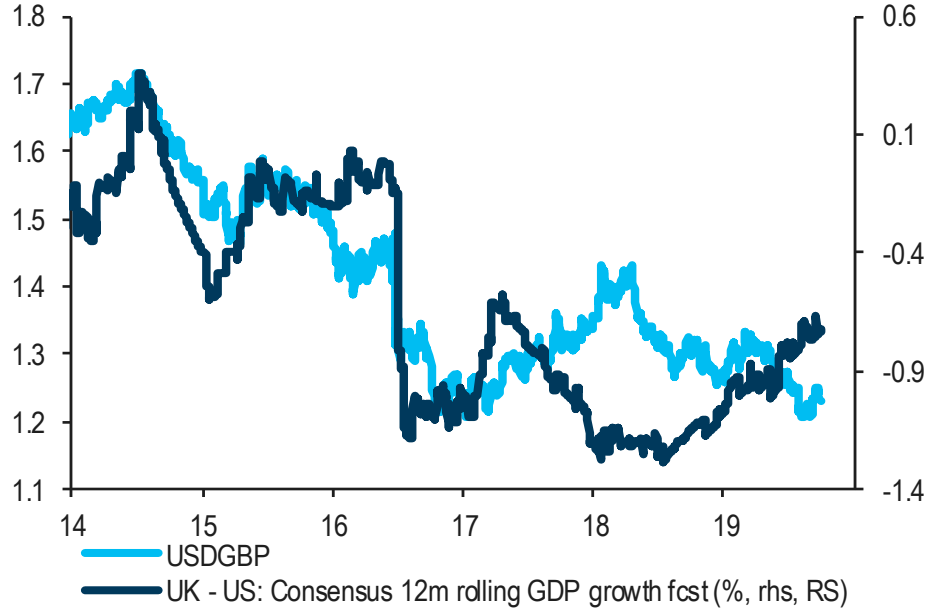


Source: Barclays Research, Bloomberg, Worldscope, company reports.

Beyond Brexit, growth and rates differential are the key drivers of GBP

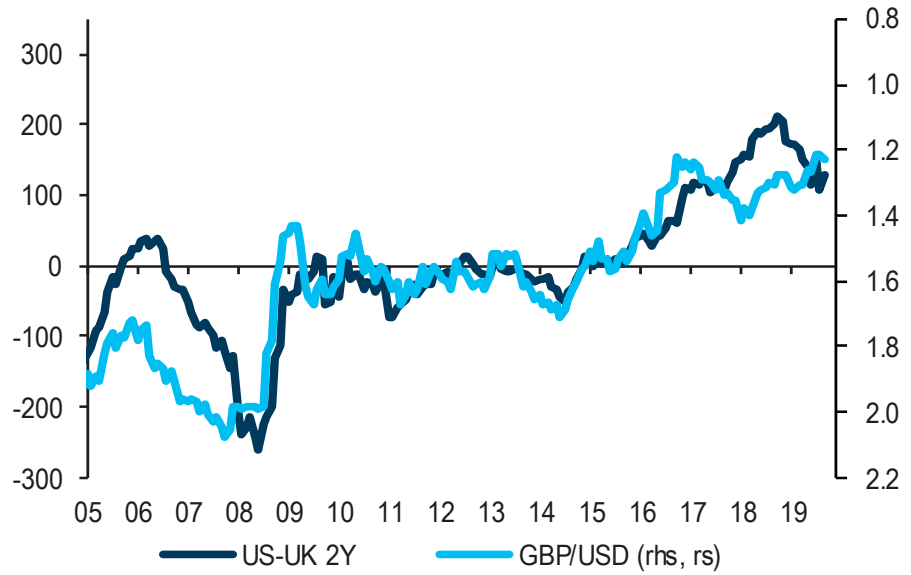
- Beyond Brexit, the key medium-term drivers of the currency remain the growth and rate differential between the UK and ROW.
- Both continue to point to limited fundamental upside to the currency.

UK / US GDP growth differential is a good indicator of GBP



Source: Worldscope, Bloomberg, Barclays Research

The rate differential between UK and US is also important for GBP direction



Source: Datastream, Barclays Research

What would No Deal mean for the UK economy? And for Eurozone?

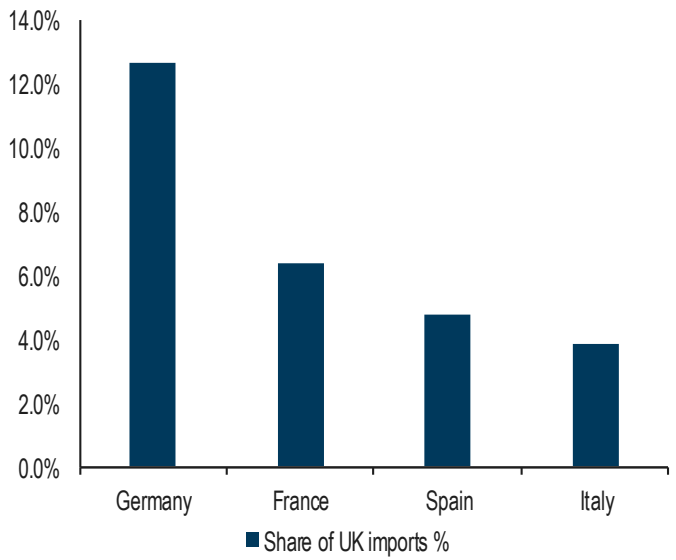
- We expect the UK to enter a shallow recession in 2020, with GDP at -0.5% y/y. The BOE will look through an initial spike in inflation, to cut rates by 50bps by Q2'20. New fiscal spending measures would likely be brought forward, to help mitigate some of the negative impact on growth. With our forecasts based on a reasonably benign scenario, risks are tilted to the downside, as disruption and negative confidence effects could be larger than expected.
- Eurozone growth would be knocked down to 0.7% in 2020, with 80% of the downgrade attributable to a no-deal Brexit, mainly via lower net trade contributions. At a country level, faltering UK demand for European goods would be particularly crucial for already-stuttering German growth.
- Our FX strategists expect GBPUSD to find floor near 1.10 and expect EURGBP to find a ceiling at 0.97 in Q1'20.

UK to enter a shallow recession in 2020, BOE to cut rates, fiscal spending

	2018				2019				2020				Calendar year average			
% Change q/q	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	2017	2018	2019F	2020F
Real GDP	0.1	0.4	0.7	0.2	0.5	-0.2	0.3	0.2	0.2	-0.5	-0.4	0.1	...	...	...	...
Real GDP (saar)	0.2	1.6	2.8	0.9	2.0	-0.8	1.1	0.9	0.7	-2.0	-1.4	0.3	...	...	...	...
Real GDP (y/y)	1.2	1.4	1.6	1.4	1.8	1.2	0.8	0.8	0.5	0.2	-0.5	-0.6	1.8	1.4	1.2	-0.1
Private consumption	0.5	0.5	0.3	0.3	0.6	0.5	0.4	0.3	0.2	-0.1	-0.1	0.1	2.1	1.7	1.7	0.6
Public consumption	0.2	-0.4	-0.1	1.3	0.8	0.7	0.7	0.7	0.5	0.5	0.5	0.5	-0.2	0.4	2.7	2.3
Investment	-0.8	-0.6	0.9	-0.6	1.2	-1.0	0.5	0.0	-2.1	-1.0	-0.8	-0.5	3.5	0.2	0.5	-3.3
Inventories (pp)	0.0	0.6	0.3	0.0	2.6	-3.8	0.1	0.5	0.2	-0.4	-0.4	0.0	-0.5	0.4	0.3	-0.8
Net exports (pp)	-0.2	-0.4	0.0	-0.2	-2.9	3.3	-0.3	-0.6	0.1	0.0	0.1	0.0	0.5	-0.2	-0.9	0.4
Nominal GDP (y/y)	3.1	3.4	3.5	3.2	3.5	3.2	2.7	3.1	2.8	2.9	2.3	2.3	4.1	3.3	3.1	2.6
Employment (Mn)	32.3	32.4	32.4	32.6	32.7	32.8	32.7	32.7	32.6	32.6	32.5	32.4	32.1	32.4	32.7	32.6
Employment growth	0.6	0.1	0.1	0.5	0.3	0.3	-0.2	0.0	-0.3	0.0	-0.3	-0.3	1.0	1.2	0.9	-0.6
Unemployment rate (%)	4.2	4.0	4.1	4.0	3.8	3.9	4.0	4.3	4.7	4.9	5.4	5.7	4.4	4.0	4.3	5.7
CPI inflation (%y/y)	2.7	2.4	2.5	2.3	1.9	2.0	1.8	2.0	2.8	2.8	2.8	2.9	2.7	2.5	2.0	2.8
Current account (% GDP)	-3.4	-3.3	-4.3	-4.4	-5.6	-2.2	-2.5	-3.1	-3.0	-3.0	-2.9	-2.9	-3.3	-3.9	-3.3	-2.9
Government balance (% GDP)	...	...	...	...	...	...	...	...	...	...	...	...	-2.0	-1.1	-1.5	-2.5
Government debt (% GDP)	...	...	...	...	...	...	...	...	...	...	...	...	84.6	83.0	83.5	84.2
Bank Rate (EOP)	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.50	0.25	0.25	0.25	0.50	0.75	0.75	0.25

Source: UK Economics Research and Eurozone Economics (both 27 Sept 2019)

Germany is the most exposed to UK trade

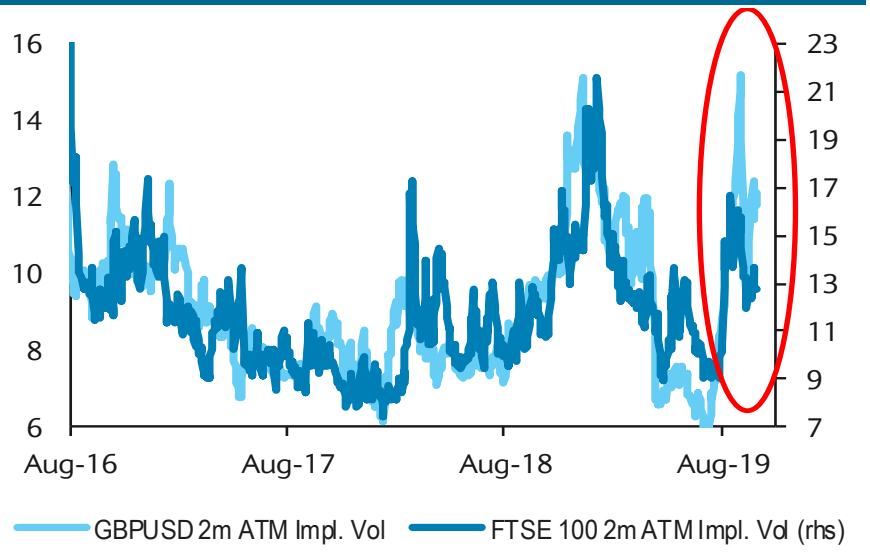


Source: ONS, Haver.

UK Implied Volatility & Skew covering the Oct 31st Brexit date is elevated

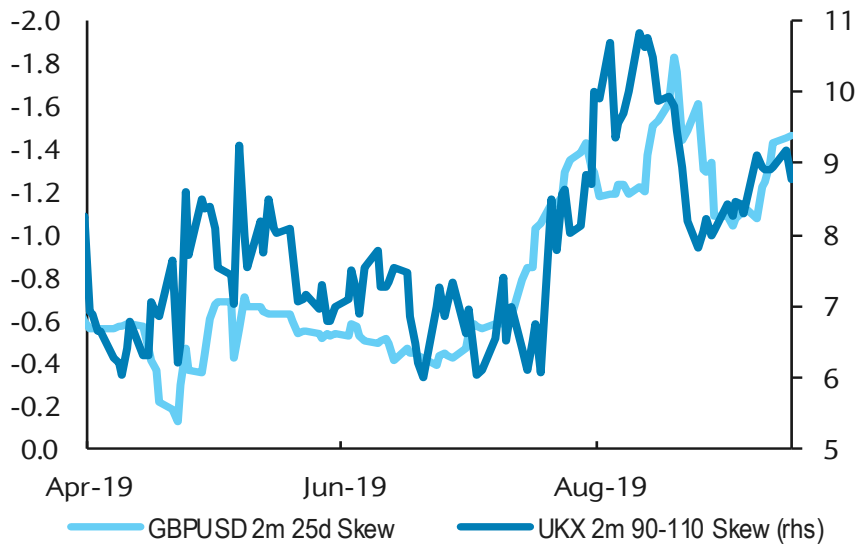
- FTSE 100 implied vol is naturally depressed vs. other equity markets, as the high proportion of overseas earners means GBP acts as a natural stabiliser to earnings. It is also relatively more defensive than other equity markets.
- Investors seem to prefer to hedge UK assets directly with GBP volatility rather than FTSE 100.
- The 'no-deal' rhetoric and proximity of the current Brexit date of 31st October are clearly having an effect on investor hedging behaviour with both Implied Vol & Skew picking up.
- They may be elevated but they haven't yet reached highs set in previous episodes.
- We would expect GBP & UKX vol to increase further in coming days should the UK govt. proposal on the Irish backstop fail to gain traction.

FTSE 100 & GBPUSD 2m ATM Implied Volatility



Source: Bloomberg, Barclays Live

FTSE 100 & GBPUSD 2m downside Skew

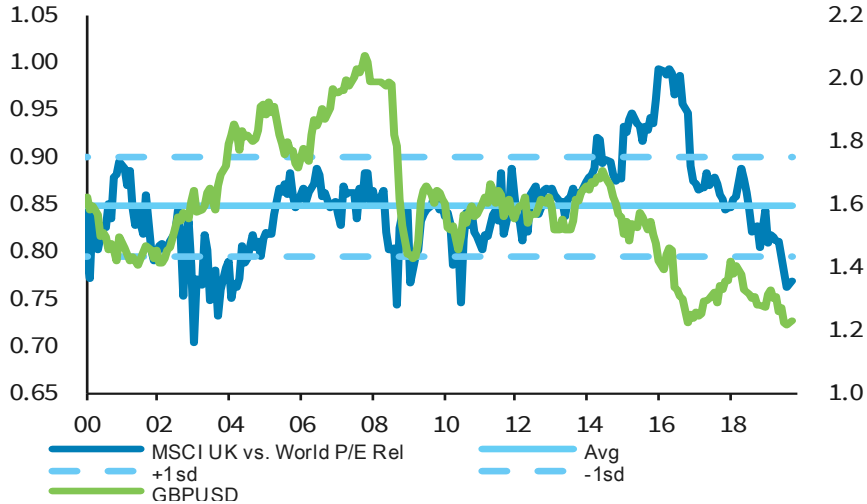


Source: Bloomberg, Barclays Live

UK PLC available at discounted price – inbound M&A to increase?

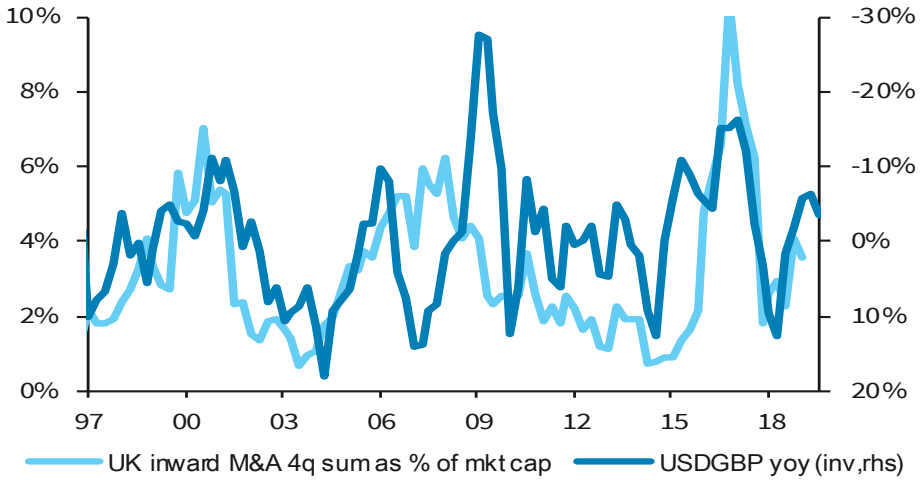
- In the past, falls in GBP have been associated with spike in inbound M&A.
- For those investors willing/able to play the long game, UK PLC must look particularly attractive to overseas investors right now, with P/E relative trading near trough and GBP near multi decade lows.
- We are already seeing a spike in incoming M&A on the recent fall in GBP.

UK equities cheap – cheapened both by currency fall and P/E de-rating vs. RoW



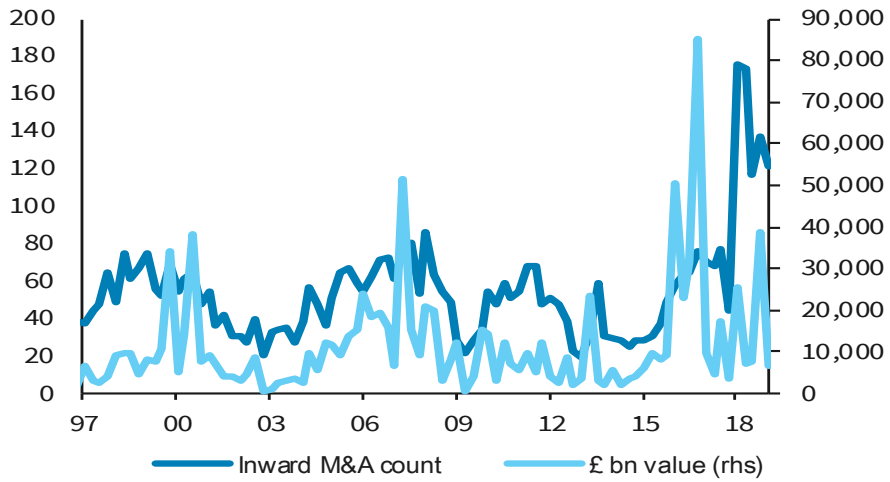
Source: Refinitiv, Barclays Research

Inbound M&A already on the rise as GBP falling



Source: Refinitiv, Barclays Research

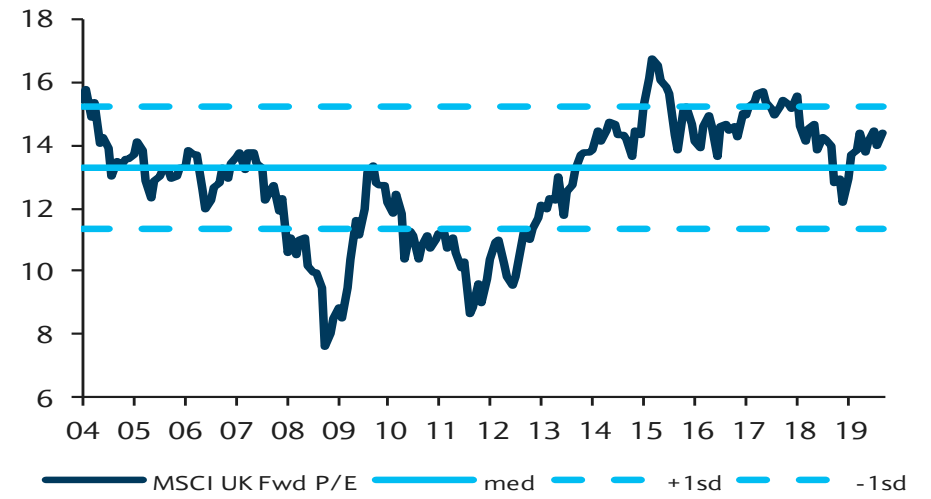
Both deal count and value likely to increase



Source: Refinitiv, Barclays Research

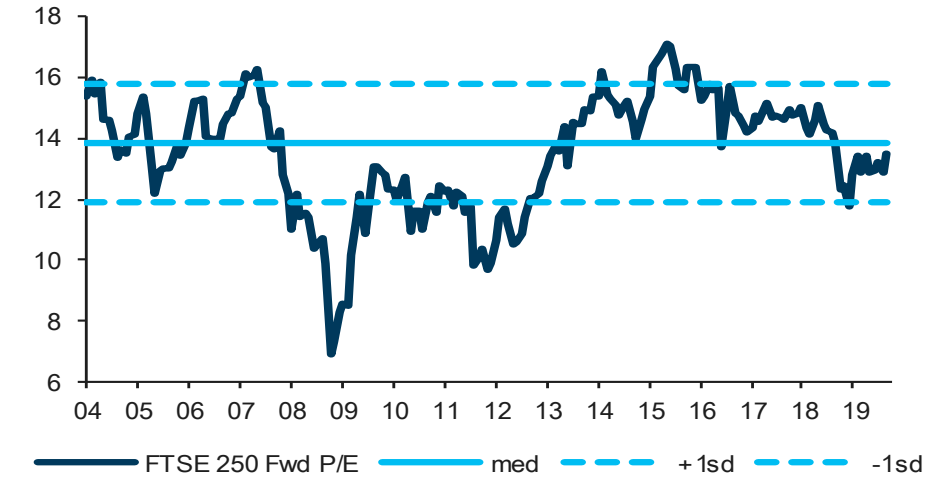
FTSE 100 & 250 absolute valuations

MSCI UK P/E is above historical median



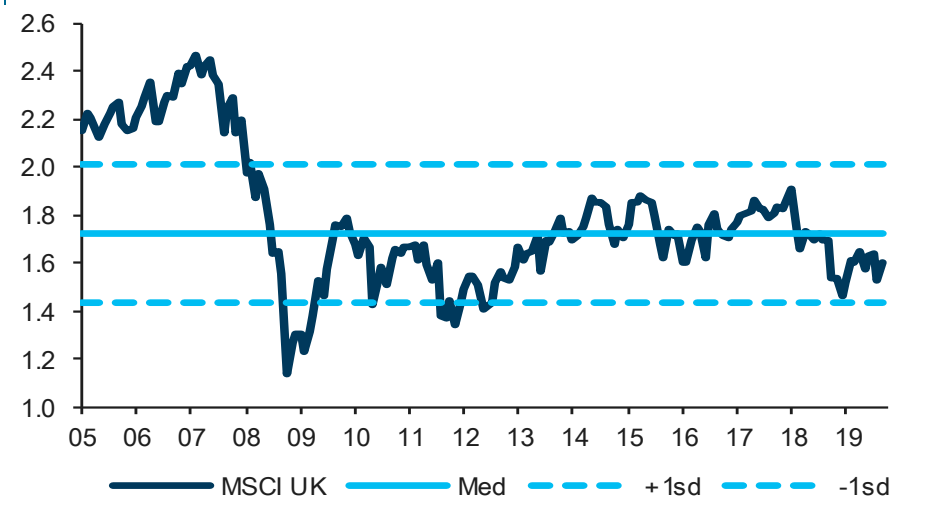
Source: IBES

FTSE 250 P/E has bounced but remains cheap



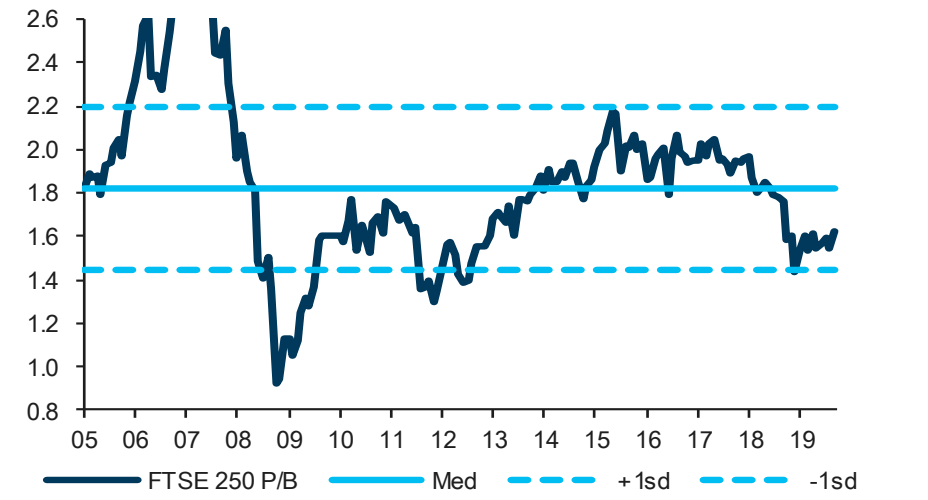
Source: IBES

MSCI UK P/B below historical median



Source: IBES

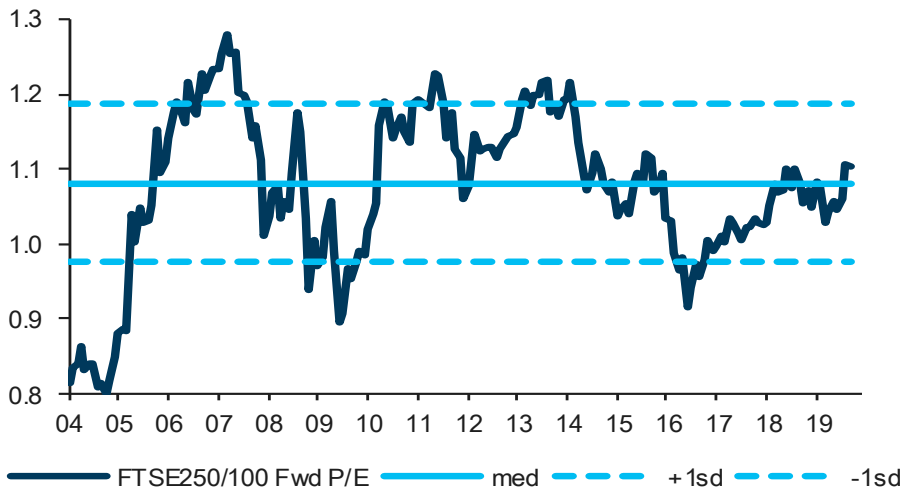
MSCI UK P/B below historical median



Source: IBES

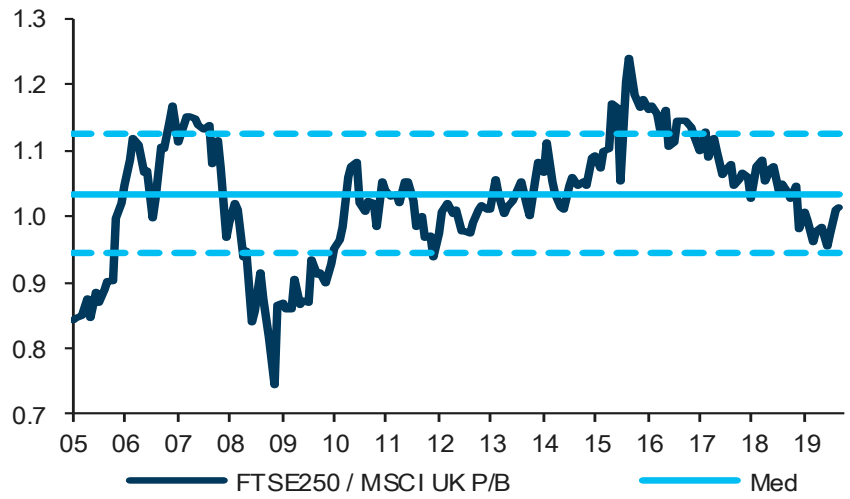
FTSE 100 & 250 relative valuations

FTSE 250 vs 100 P/E is at median levels



Source: IBES

FTSE 250 vs 100 P/B near 1 stdev cheap



Source: IBES

MSCI UK Sector Valuations

	F12m EPS Growth	F12m P/E	P/E dev from 13yr med (%)	P/B	Div Yield
MSCI UK	6.0	12.2	-0.1	1.7	4.8
MSCI UK ex Fins	7.5	13.7	4.7	3.4	4.7
Energy	12.0	10.6	0.5	1.2	6.8
Materials	0.5	10.2	-10.0	1.7	5.9
Industrials	9.7	17.5	21.6	4.7	2.3
Tech	8.2	15.8	-23.9	2.9	3.1
Cons Disc	4.5	14.2	6.1	2.7	3.8
Cons Staples	8.1	13.0	-13.9	2.4	3.5
Telecommunications	16.8	13.0	4.4	0.9	6.3
Healthcare	6.8	17.2	31.5	10.7	3.6
Utilities	4.1	13.4	1.2	1.8	6.9
Banks	0.3	8.9	-11.2	0.7	6.2
Diversified Financials	8.4	16.3	25.8	2.3	3.1

Source: IBES

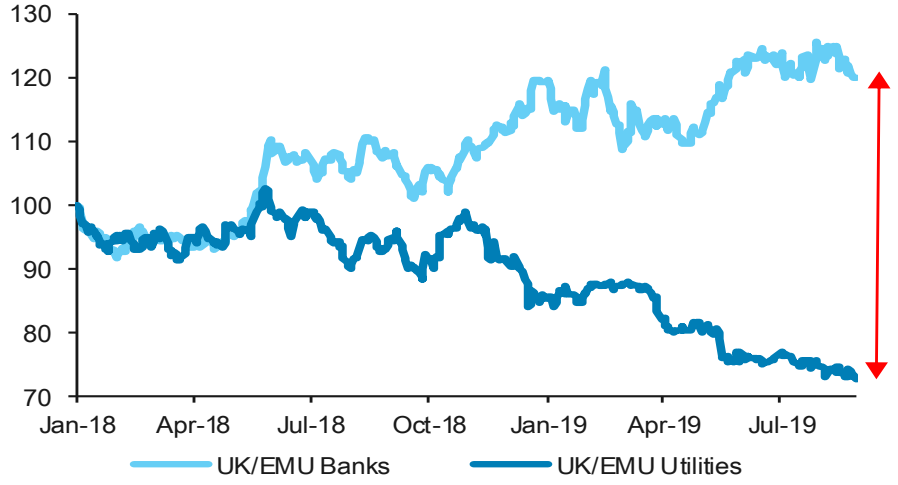
FTSE 250 Sector Valuations

	F12m EPS Growth	F12m P/E	P/E dev from 13yr med (%)	P/B	Div Yield
FTSE 250	6.1	13.5	-1.0	1.5	3.6
FTSE 250 ex Fins	6.0	14.3	0.3	2.0	3.4
Energy	1.9	11.6	-18.4	1.0	3.8
Materials	3.9	9.6	-22.9	1.7	4.0
Industrials	7.3	14.5	4.5	2.1	3.2
Tech	10.0	21.2	28.8	5.1	2.5
Consumer Goods	5.3	10.4	-12.7	1.5	4.9
Consumer Services	5.5	13.4	-0.5	1.6	3.1
Telecommunications	2.6	26.1	44.7	3.1	3.2
Healthcare	2.4	21.2	7.9	2.1	1.7
Utilities	14.1	12.0	-18.6	1.3	6.3
Banks	1.3	6.8	-26.5	0.6	5.5
Financial Services	7.9	11.0	-11.0	1.7	4.9

Source: IBES

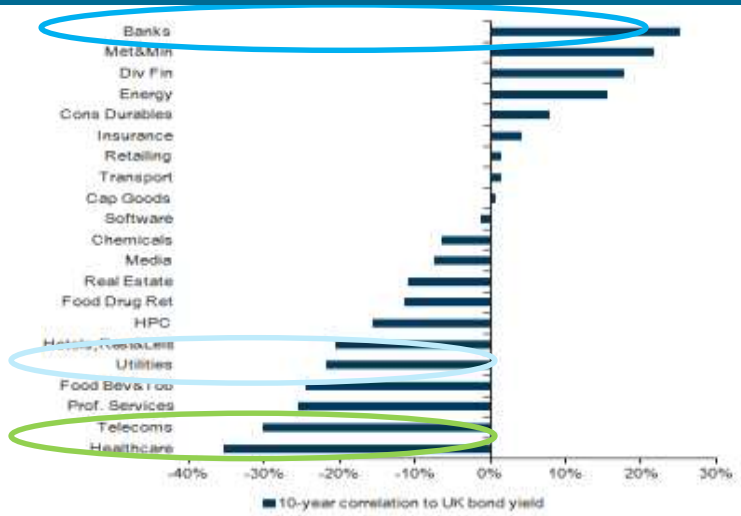
Bond yields and GBP direction matter for UK sector performance

UK Utilities have performed opposite to Banks relative to Eurozone peers



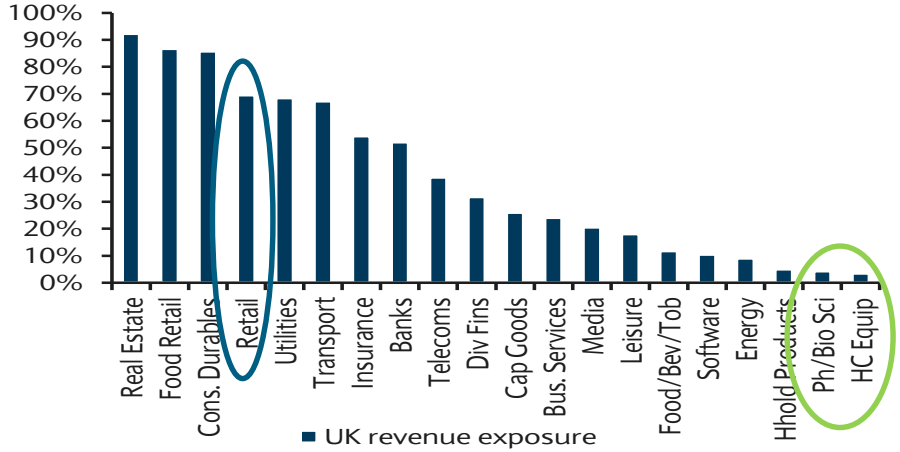
Source: Datastream

UK sectors correlation to bond yields



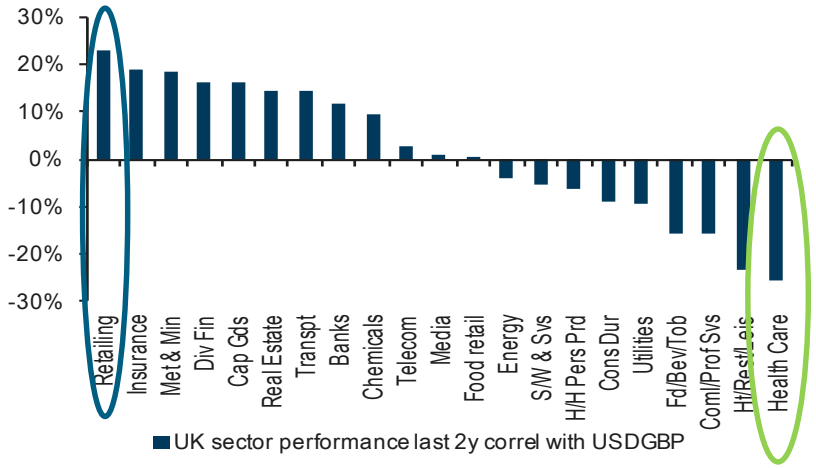
Source: Datastream, Barclays Research

UK sectors' domestic revenue exposure



Source: Worldscope, Bloomberg, Barclays Research

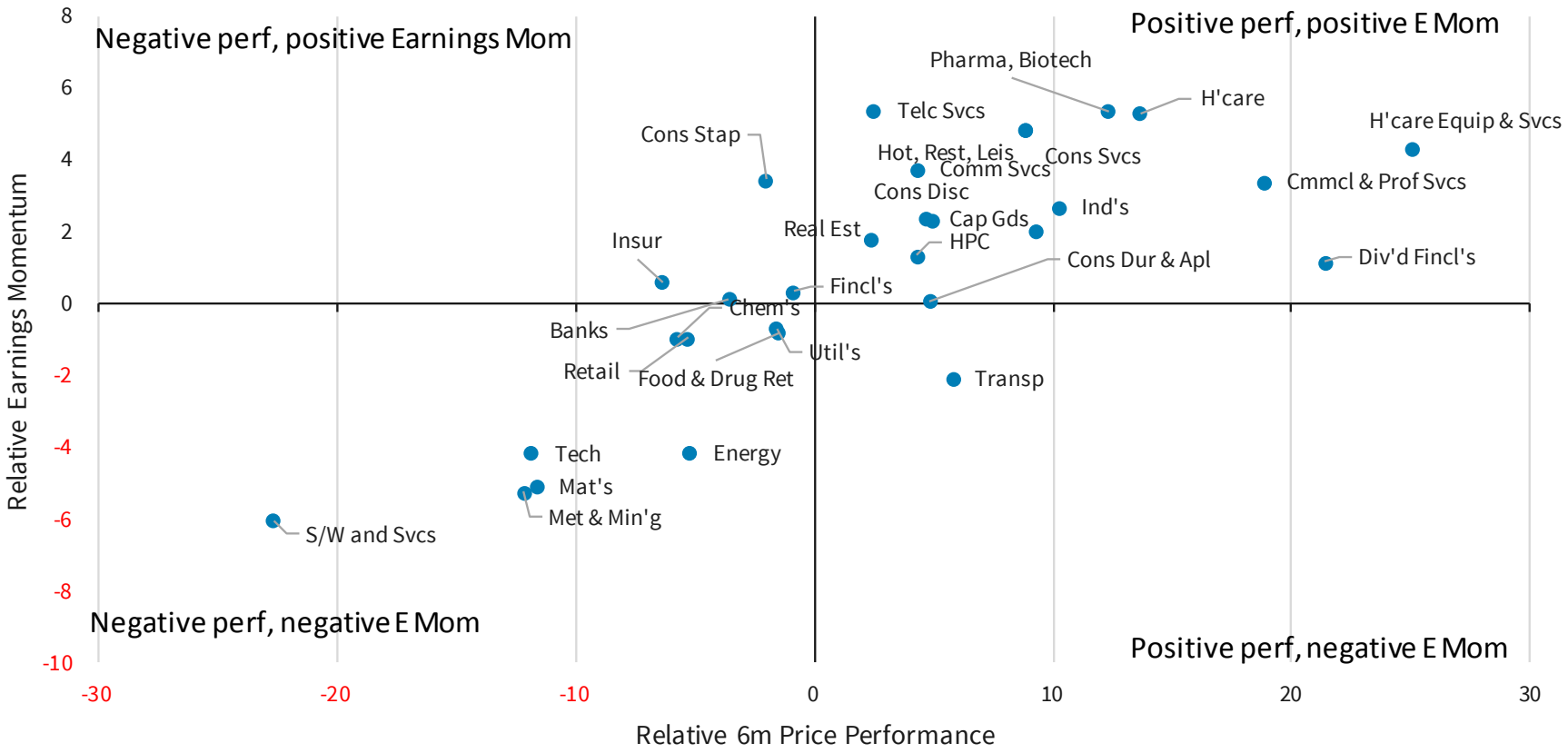
UK sectors' correlation to GBP



Source: Datastream, Barclays Research

Selected domestic plays offer value and attractive medium-term risk-reward

MSCI UK sectors EPS vs. price momentum



Source: IBES, MSCI, Refinitiv

UK domestic and exporters baskets

Barclays UK exporters basket (BCEUUKEX)

Ticker	Name	Sector	Mcap($bn)	Non-UK exposure
BRBY LN	Burberry Group	C Disc	9.3	89%
CCL LN	Carnival	C Disc	8.7	100%*
CPG LN	Compass Group	C Disc	33.9	91%
IHG LN	Ictl.Htls.Gp.	C Disc	10.4	96%
INF LN	Informa	C Disc	10.4	91%
PSON LN	Pearson	C Disc	10.0	91%
BATS LN	British American Tobacco	C Staples	74.0	99%
DGE LN	Diageo	C Staples	85.1	94%
IMB LN	Imperial Brands	C Staples	29.6	90%
RB/ LN	Reckitt Benckiser Group	C Staples	56.1	95%
RDSA LN	Royal Dutch Shell A	Energy	134.9	100%*
III LN	3I Group	Financials	10.2	89%
HSBA LN	HSBC Holdings	Financials	165.4	77%
OMU LN	Old Mutual Limited	Financials	8.2	100%*
PRU LN	Prudential	Financials	48.2	68%
AZN LN	Astrazeneca	Health Care	90.1	86%
GSK LN	Glaxosmithkline	Health Care	95.6	97%
SN/ LN	Smith & Nephew	Health Care	16.1	95%
AHT LN	Ashtead Group	Industrials	11.5	87%
ITRK LN	Intertek Group	Industrials	10.2	93%
MRO LN	Melrose Industries	Industrials	10.6	95%
REL LN	Relx	Industrials	41.0	93%
RR/ LN	Rolls-Royce Holdings	Industrials	21.1	88%
SGE LN	Sage Group	IT	8.3	80%
EVR LN	Evraz	Materials	9.0	100%
FRES LN	Fresnillo	Materials	8.8	100%
RIO LN	Rio Tinto	Materials	63.6	99%
VOD LN	Vodafone Group	Telecom	51.5	85%
NG/ LN	National Grid	Utilities	34.6	60%

Source: Bloomberg, IBES, Datastream, Barclays Research.
See European Equity Strategy: UK: Bumpy ride ahead, but low GBP helps, 19 June 2019, for all relevant disclosures.

Barclays UK domestic basket (BCEUUKDM)

Ticker	Name	Sector	Mcap ($bn)	UK exposure
PSN LN	Persimmon	C Disc	9.9	100%
BDEV LN	Barratt Developments	C Disc	7.0	100%
BKG LN	Berkeley	C Disc	6.2	100%
TW/ LN	Taylor Wimpey	C Disc	7.2	98%
WTB LN	Whitbread	C Disc	9.3	96%
NXT LN	Next	C Disc	9.9	91%
MKS LN	Marks & Spencer	C Disc	6.2	89%
ITV LN	ITV	C Disc	8.6	72%
PPB ID	Paddy Power Betfair	C Disc	7.5	61%
SBRY LN	Sainsbury J	C Staples	9.3	100%
MRW LN	Morrison (WM) Spmkts.	C Staples	7.9	100%
ABF LN	Associated Brit. Foods	C Staples	24.2	43%
LLOY LN	Lloyds Banking Group	Financials	56.1	100%
HL/ LN	Hargreaves Lansdown	Financials	12.9	100%
LGEN LN	Legal & General	Financials	20.2	98%
RBS LN	Royal Bank Of Sctl.Gp.	Financials	37.8	93%
AV/ LN	Aviva	Financials	25.1	55%
RMG LN	Royal Mail	Industrials	5.9	78%
EZJ LN	easyJet	Industrials	7.9	45%
RMV LN	Rightmove	IT	5.7	97%
BLND LN	British Land	Real Estate	7.9	100%
LAND LN	Land Securities Group	Real Estate	8.8	100%
BT/A LN	BT Group	Telecom	28.8	81%
UU/ LN	United Utilities Group	Utilities	6.4	100%
SSE LN	SSE	Utilities	16.4	97%
SVT LN	Severn Trent	Utilities	6.0	90%

Source: Bloomberg, IBES, Datastream, Barclays Research.
For more information see Navigating troubled waters - 'Crash out' unlikely but UK stocks still face challenges, 12 Sept 2018.

3) Challenging EM, trade and Autos backdrops call for caution on Germany

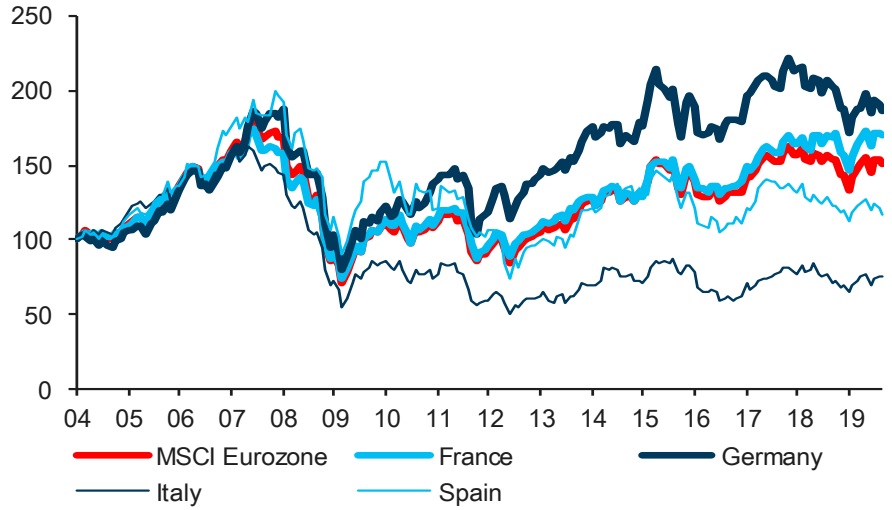
- Eurozone countries have enjoyed mixed fortunes over the last decade. Country performance within the Eurozone has broadly followed the earnings delivery over the last few years.
- Germany underperformed sharply in 2018, but has outperformed ytd. It could be at risk if the trade/tariff escalation causes further EM/China/Autos weakness.
- Italian equities have barely moved since 2009. They rebounded ytd as BTP spreads narrowed, but macro fundamentals are still weak.

Eurozone countries performance, valuations and earnings forecasts

	Performance		EPS		Fwd P/E				
	YTD	12m	'19e y/y	'20e y/y	Current	20Y	% Diff	DY	ROE
Eurozone	**15.6%**	**-0.4%**	**1.0%**	**10.6%**	**13.4**	**13.3**	**1%**	**3.5%**	**9.9%**
France	17.8%	1.1%	1.3%	10.9%	14.0	13.4	4%	3.2%	10.3%
Germany	11.2%	-5.4%	-3.0%	13.8%	13.1	12.7	3%	3.3%	8.9%
Italy	18.7%	1.8%	5.4%	7.0%	11.0	12.8	-14%	4.4%	9.7%
Spain	7.5%	-2.5%	2.2%	6.7%	11.2	12.9	-13%	4.8%	9.6%

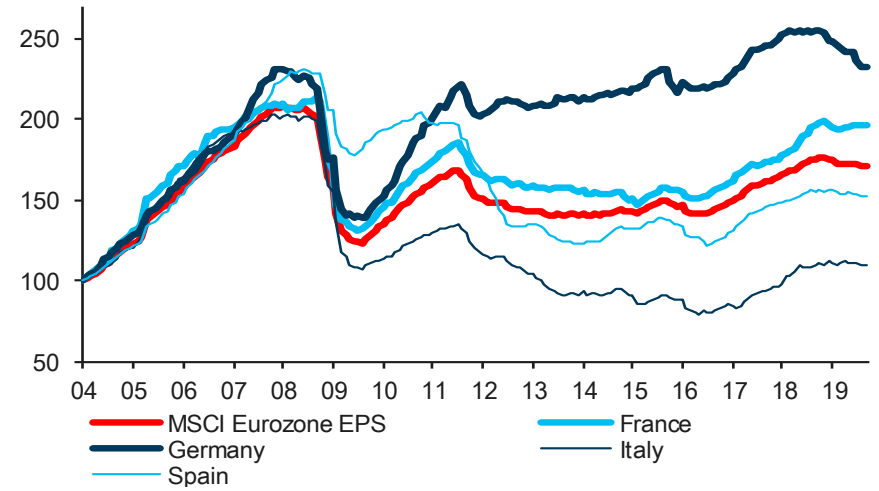
Source: Datastream, IBES

Germany has outperformed in the current cycle…



Source: Datastream, re-based to 100 in Jan-04

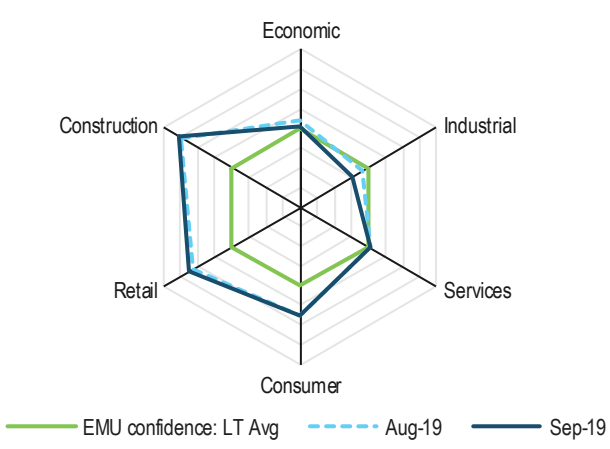
…which is due to stronger earnings



Source: IBES, re-based to 100 in Jan-04

Confidence indicators: Economic sentiment is low in the UK, better in France

Confidence Indicators: Eurozone

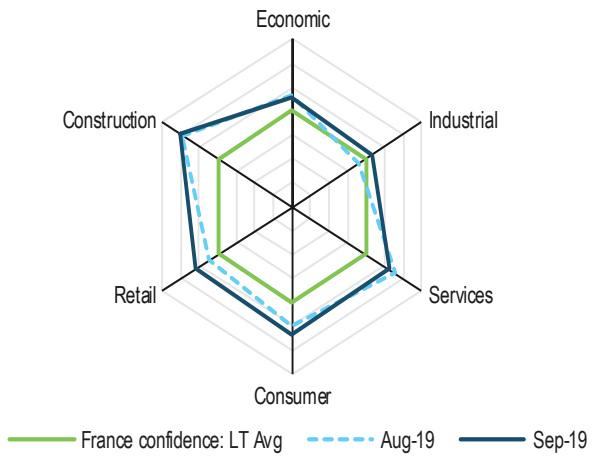


Source: European Commission

Gloomy in the UK

Source: European Commission

Better in France



Source: European Commission

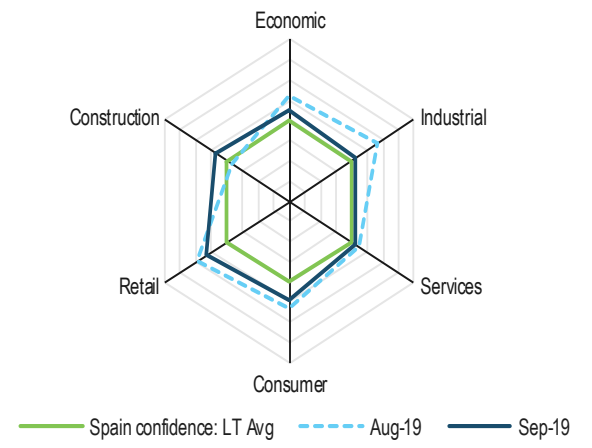
Low industrial in Germany

Source: European Commission

Most near LT average in Italy

Source: European Commission

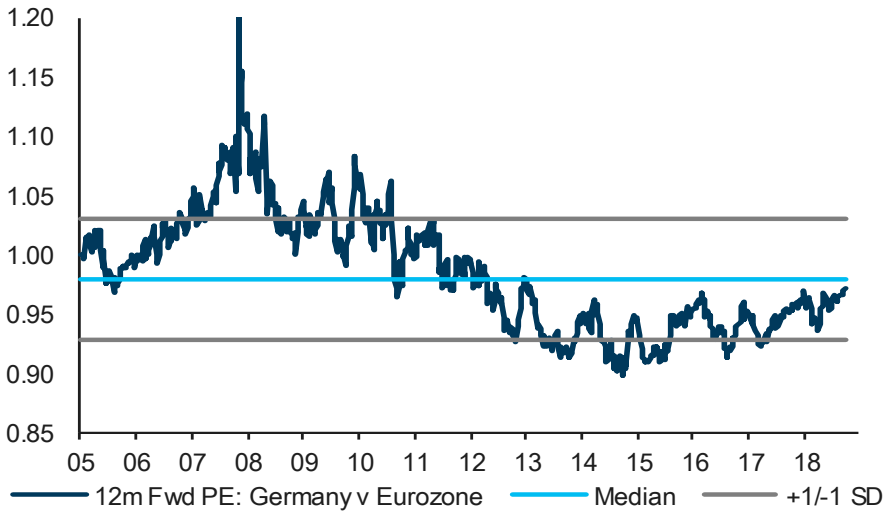
Strong consumer in Spain



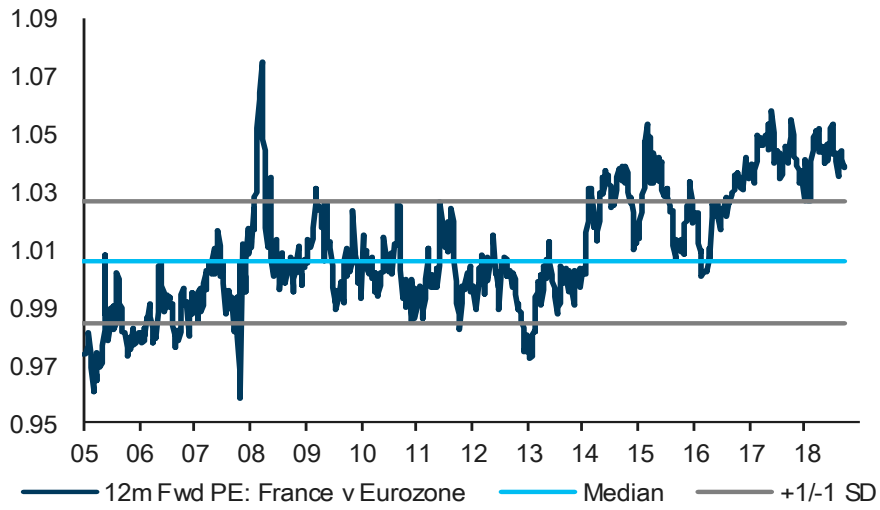
Source: European Commission

Eurozone countries valuations

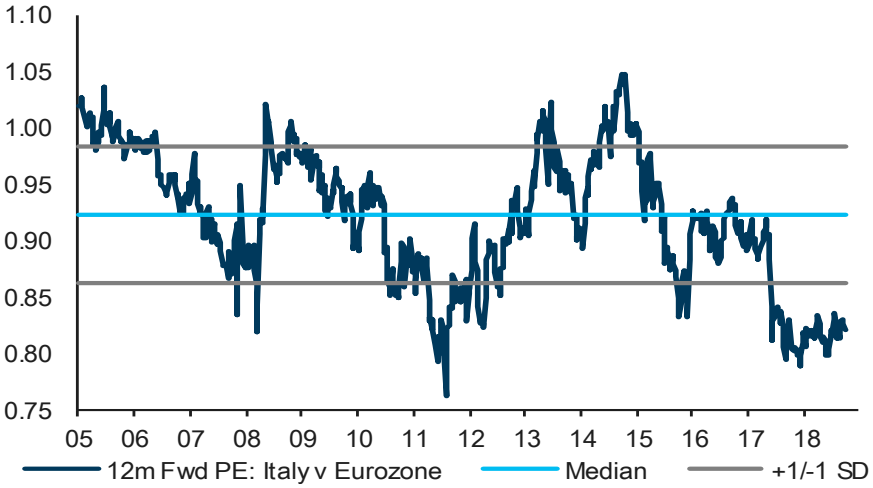
German relative P/E is in line with historical average



France appears more expensive on valuation

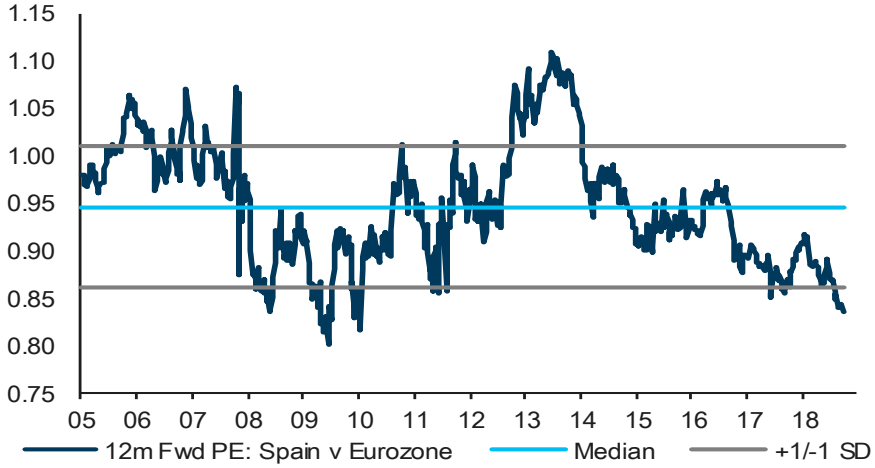


Italy valuation is at extreme lows



Source: Datastream, re-based to 100 in Jan-04

Spain valuation is also below 1SD levels



Source: IBES, re-based to 100 in Jan-04

MSCI Germany vs. Europe

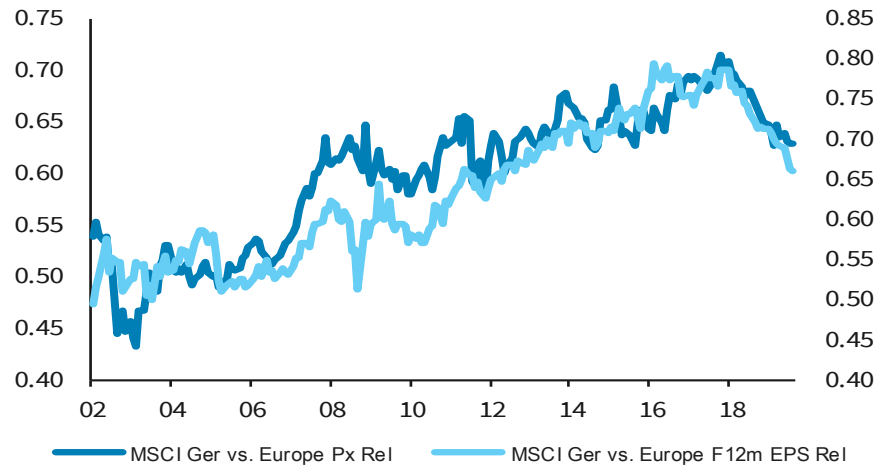
- German equities & EPS are underperforming Europe due to their heavy weight in 'old' cyclical industries and exposure to trade/exports.

Sector exposure	Germany	Europe	Germany - Europe
Energy	0%	8%	-8%
Cyclicals ex-Energy	55%	38%	17%
Defensives	28%	36%	-8%
Financials	17%	19%	-2%

Source: MSCI, Refinitiv, Barclays Research

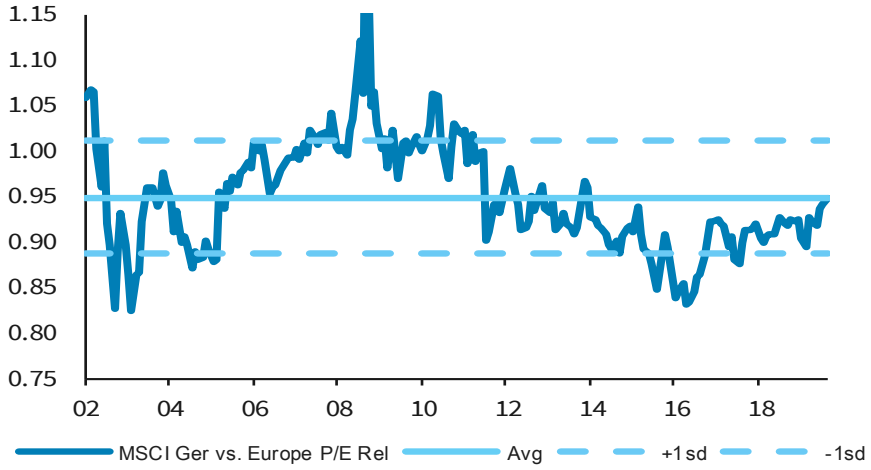
- They trade at average vs Europe on P/E & P/B.
- Relative earnings momentum is not supportive.

Price & EPS relative to Europe



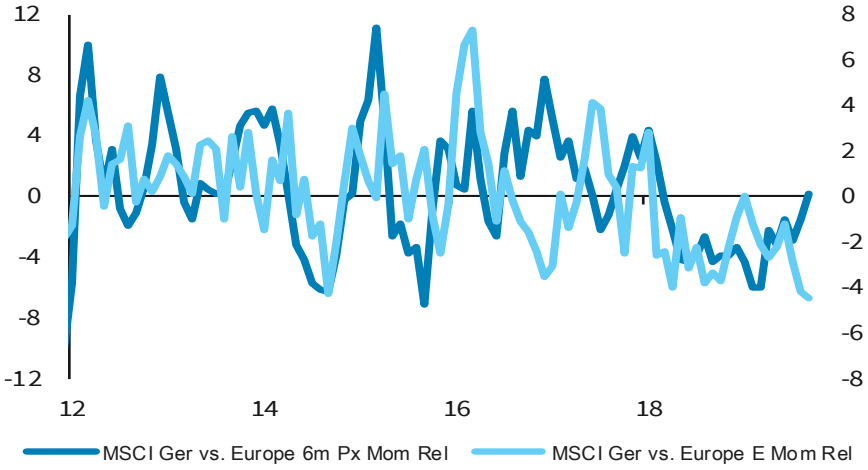
Source: MSCI, IBES, Refinitiv, Barclays Research

P/E relative



Source: MSCI, IBES, Refinitiv, Barclays Research

Relative Earnings Momentum is not supportive

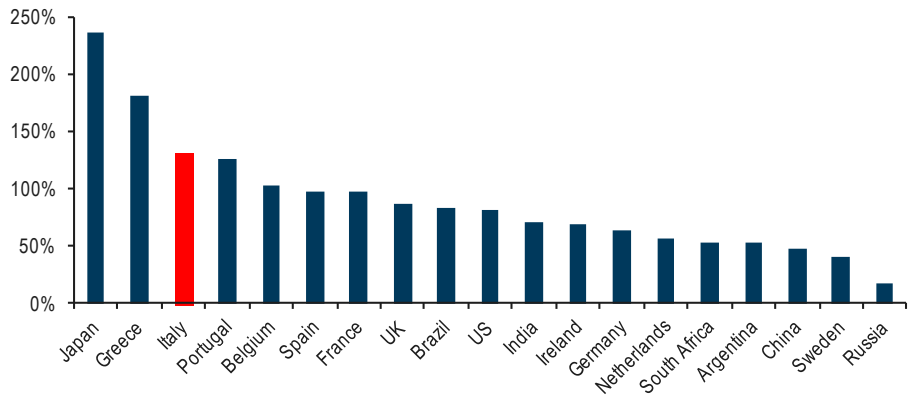


Source: MSCI, IBES, Refinitiv, Barclays Research

Italian equities have lagged the tightening in BTP spreads

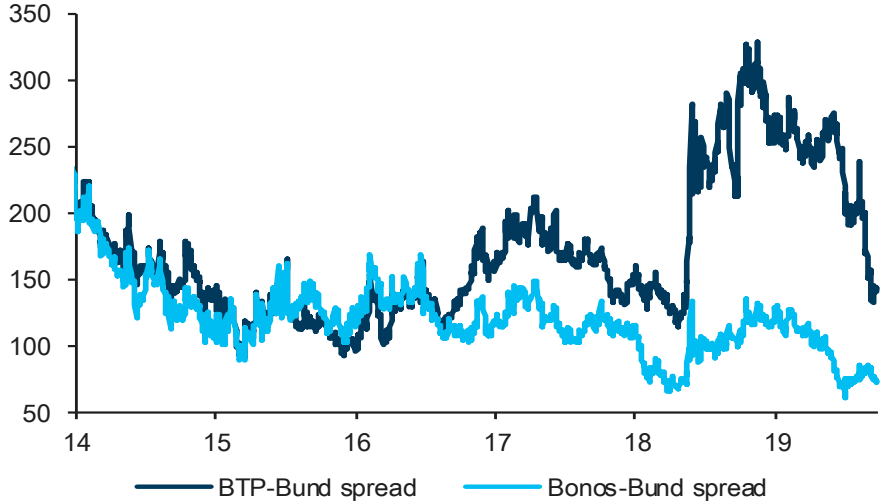
- BTPs spread have tightened sharply as the political uncertainty eased and ECB dovishness re-activated the search for yield.
- However, Italian equities have lagged the recent tightening in spreads and could have further upside to close the gap.
- However, the medium-term Italian fiscal position remains uninspiring and the debt burden is elevated.

Italy public-debt-to-GDP looks difficult to sustain at the current level



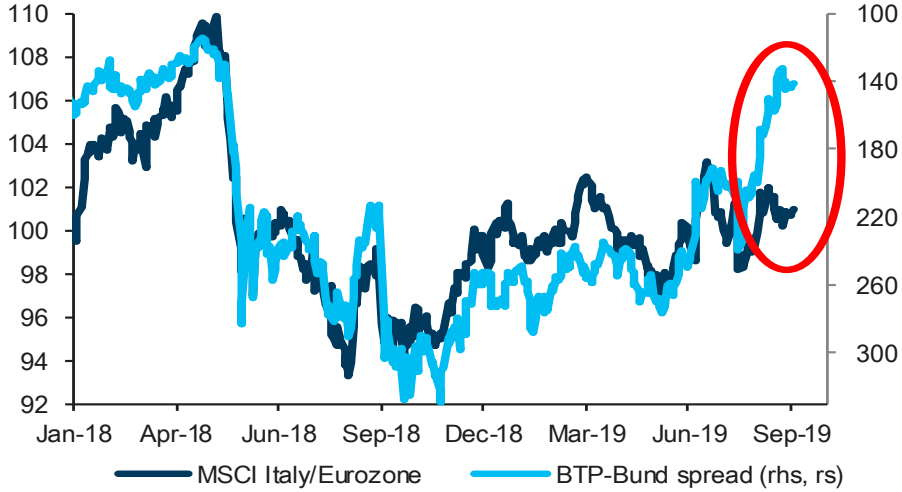
Source: Bloomberg, as of 2017

Limited contagion from Italy to Spain – this is not 2011



Source: Datastream

Italian equities have upside to close the gap with BTPs



Source: Datastream

Periphery is a call on Banks, France is well diversified and Germany is Cyclical

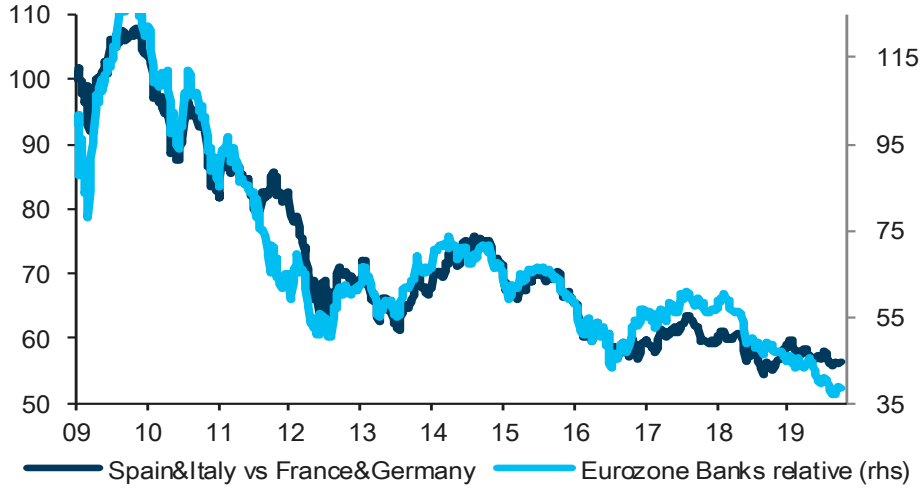
- The French equity market is the most diversified within Eurozone in terms of sector composition and is not overly dependent on Banks, contrary to Italy and Spain.
- Germany has by far the most cyclical sector composition.
- We expect the weaker euro to relatively help core over periphery.

Eurozone countries equity market cap composition

Market Cap %	Eurozone	France	Germany	Italy	Spain
Materials	7%	5%	9%	0%	0%
Industrials	15%	23%	13%	10%	10%
Discretionary	14%	19%	18%	14%	8%
IT	10%	5%	14%	0%	9%
Cyclicals	46%	52%	55%	24%	27%
Staples	11%	11%	4%	2%	0%
HealthCare	7%	7%	12%	1%	2%
Telecoms	5%	6%	6%	3%	11%
Utilities	7%	4%	4%	23%	22%
Defensives	30%	28%	25%	29%	35%
Energy	5%	8%	0%	14%	6%
Real Estate	2%	3%	4%	0%	0%
Financials	17%	10%	16%	32%	32%

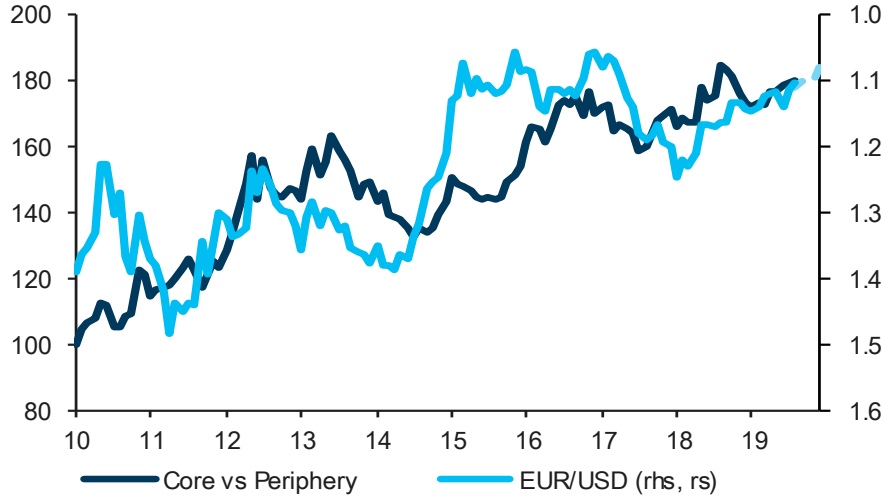
Source: Datastream

Periphery vs Core and Banks relative is the same trade



Source: Datastream

Core vs Periphery equities and EUR/USD

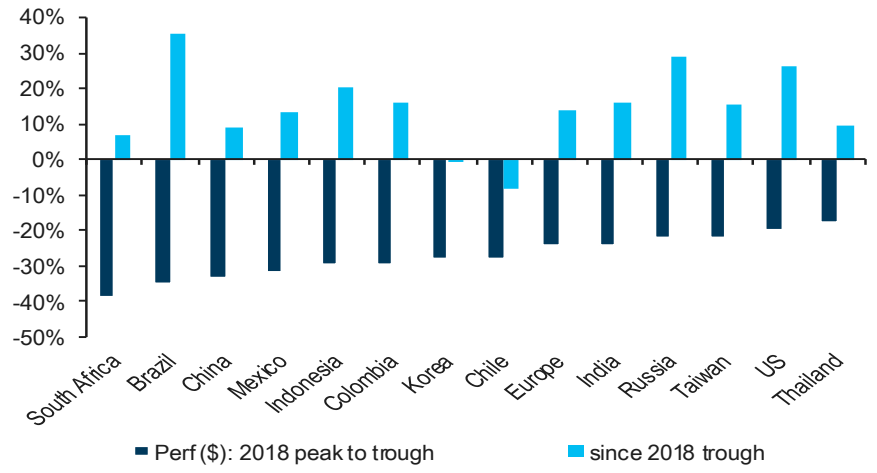


Source: Datastream, dotted line denotes Barclays FX Research forecasts

4) Stay cautious on EM exposure: Strong dollar and trade war are headwinds

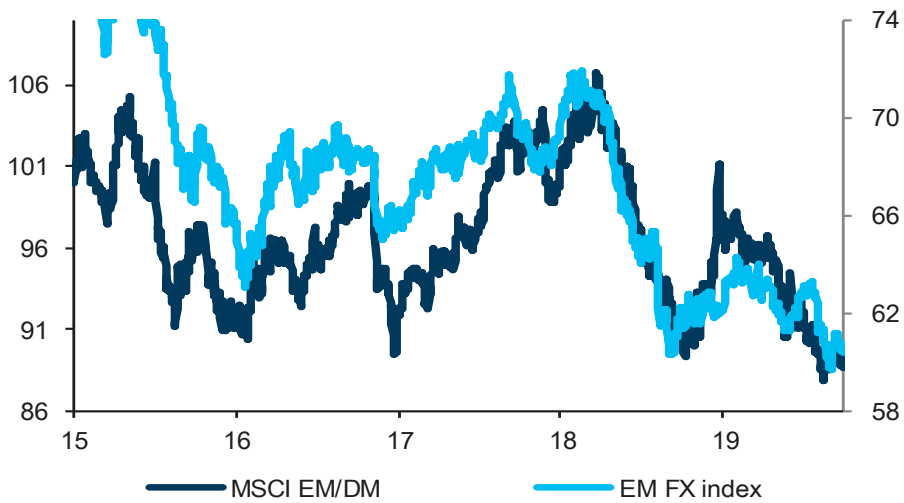
- We turned positive on EM exposure last November (**6**) as we saw the headwinds from tightening Fed liquidity and slowing Chinese growth easing, while we expected de-escalation on trade. However, we reversed to a cautious stance in early May as we saw the space facing many headwinds (**7**).
- The dovish Fed provided a boost to EM debt ytd, but the weakening activity and the renewed trade uncertainty are problematic for equities.
- The resilient dollar is another headwind for EM equities.

EM equities had a bear market in 2018



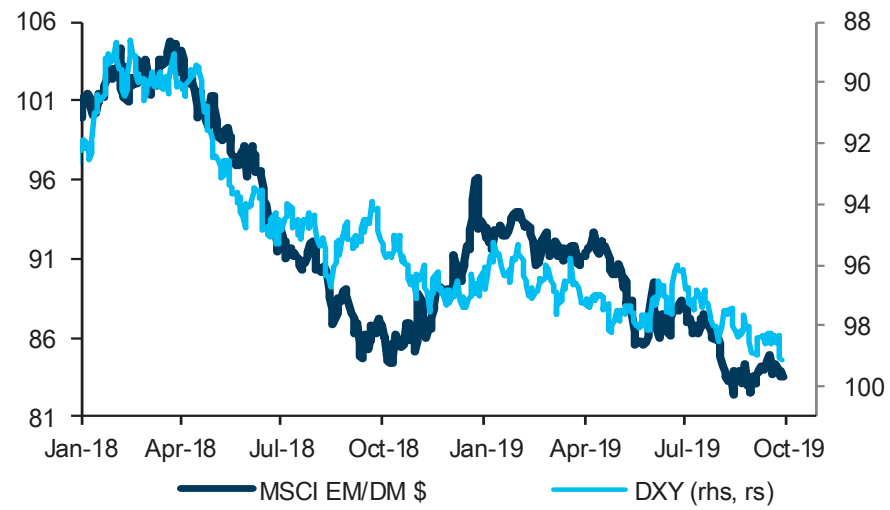
Source: Datastream

EM equities are not decoupling from EM FX



Source: Bloomberg, Barclays Research

EM/DM is mostly a dollar trade

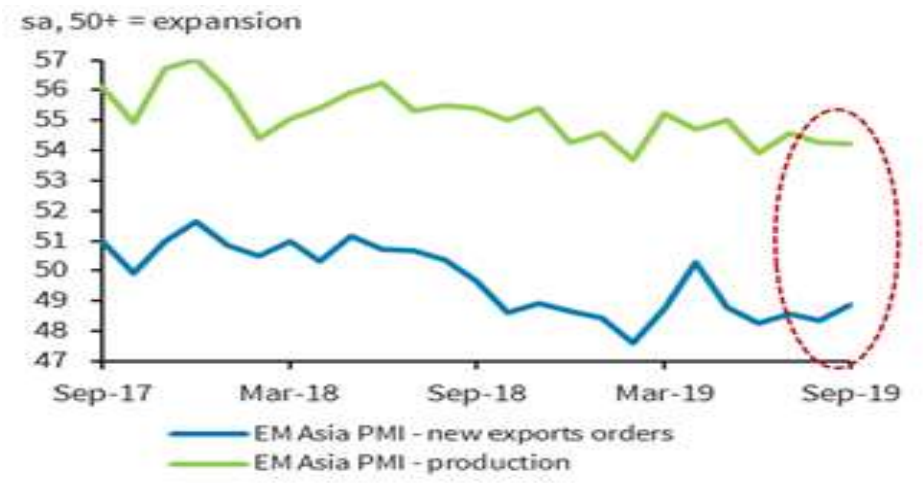


Source: Bloomberg, Datatstream

(6), (7): please refer to slide 184 for hyperlinks to previously published research reports.

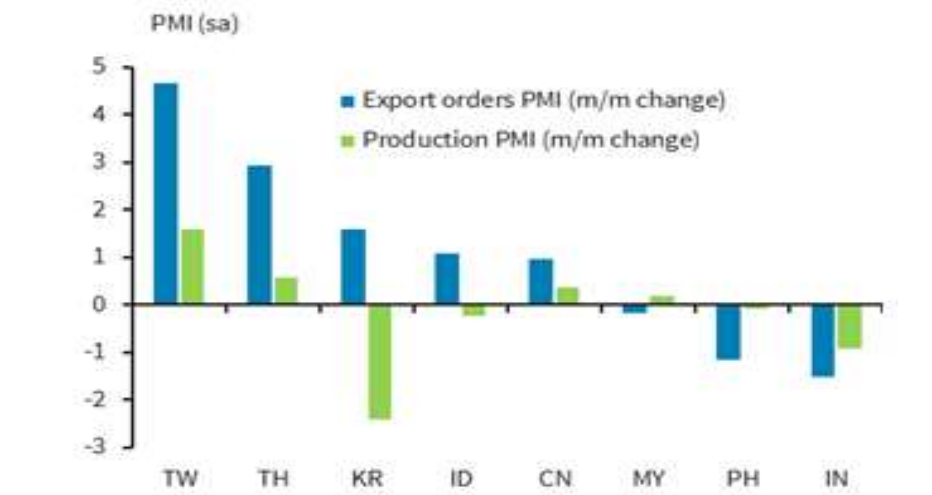
EM PMIs remain generally weak but not falling anymore

Destocking is taking place amid heightened external uncertainty



Source: Haver, Barclays EM Research

Korea shows contrasting trend between export orders and production PMI

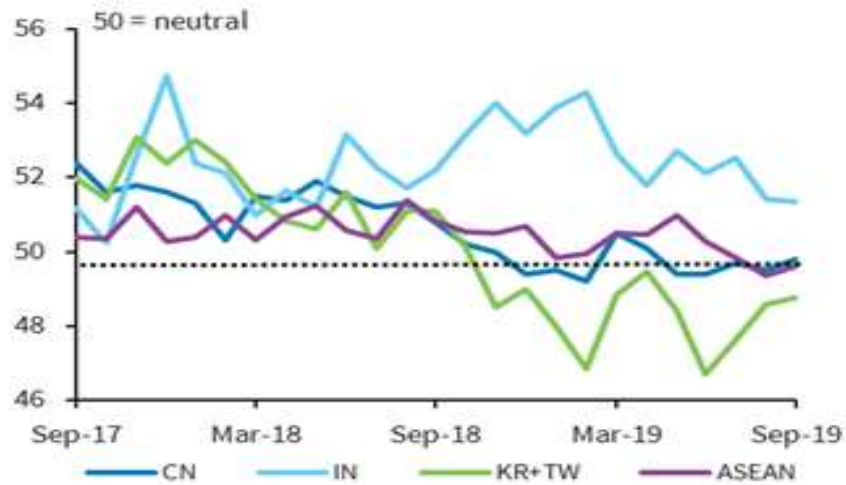


Source: Haver, Barclays EM Research

Chinese new export orders PMI improves

Source: Haver, Barclays EM Research

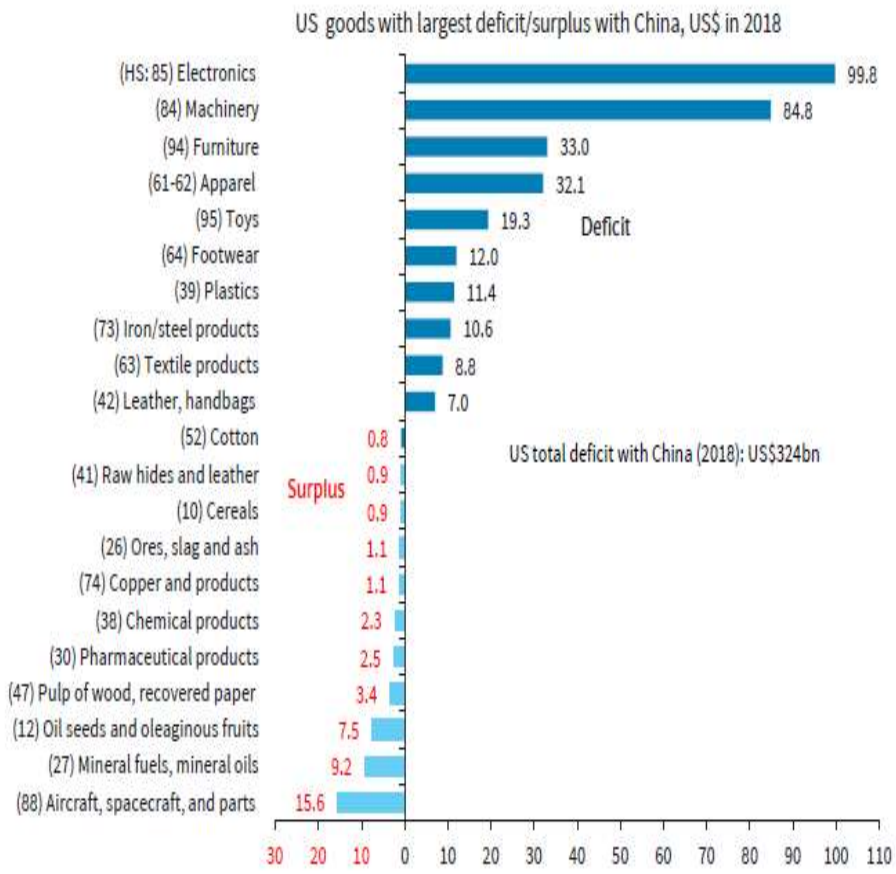
Korea and Taiwan registered largest improvements, albeit from low levels



Source: Haver, Barclays EM Research

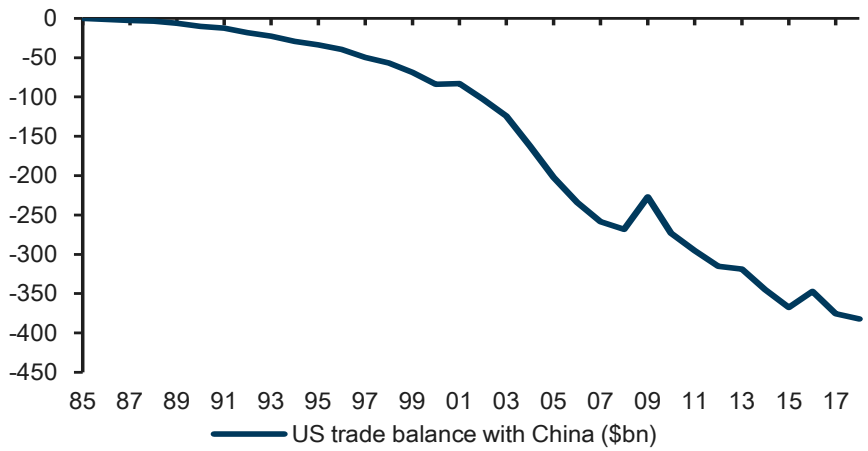
China/EM is highly dependent on trade

US goods with largest deficit/surplus with China



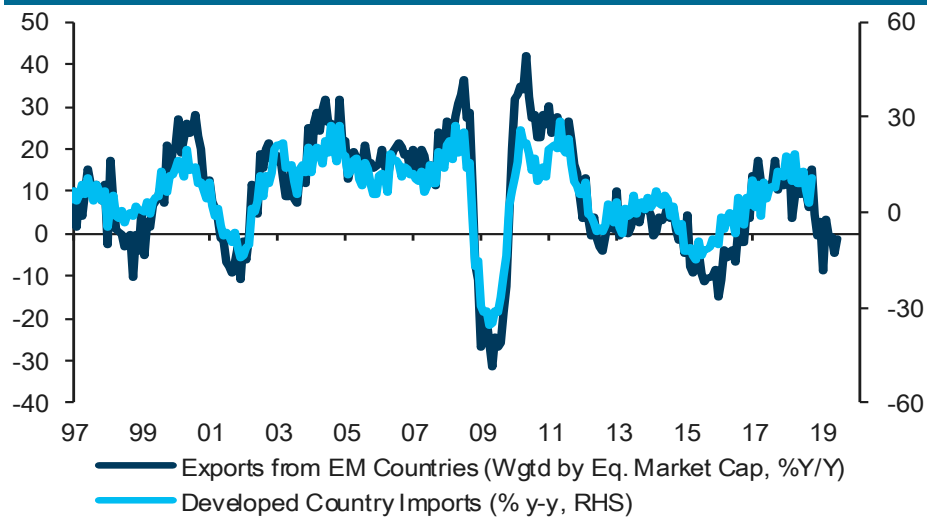
Source: Wind, Barclays Economic Research

US trade deficit with China keeps widening



Source: Census

EM exports and earnings move together

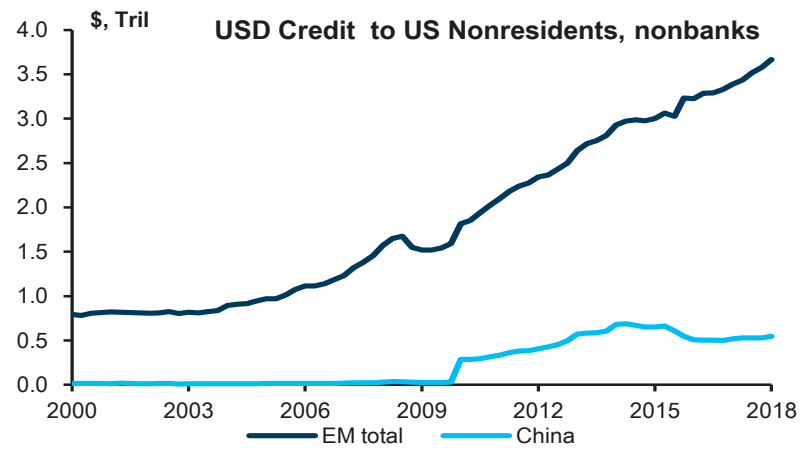


Source: Barclays Research, Datastream

Structural imbalances and dollar dependence remain

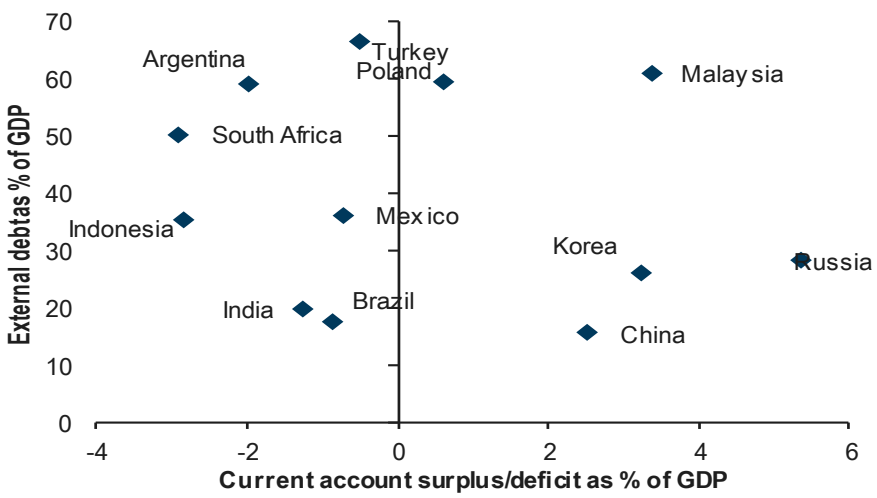
- EM structural imbalances remain plenty and many countries are overly dependent on external funding conditions.
- The unwinding of the carry trades last year hurt those with poor external debt and current account metrics pretty badly. As EM FX and yield spreads are now going the other way around, this is a relief.

A lot of credit has flown into EMs



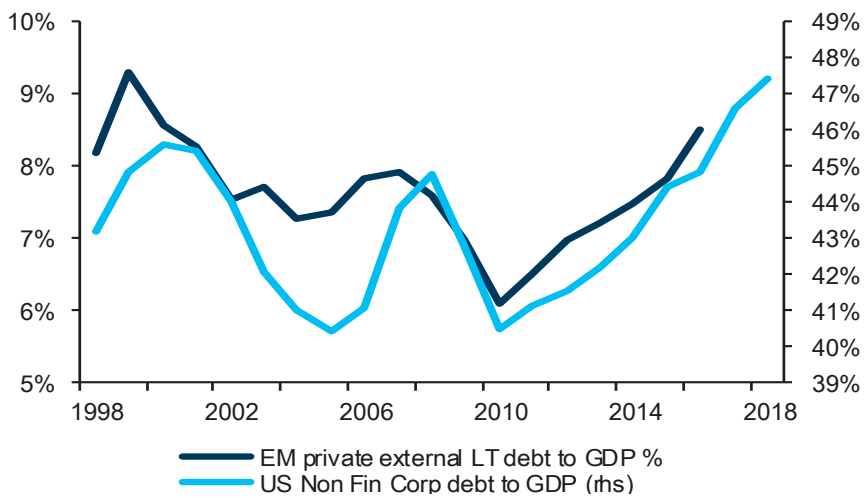
Source: BIS, Barclays Economics Research

EM countries' external debt and current account balances



Source: Datastream, World Bank, Haver

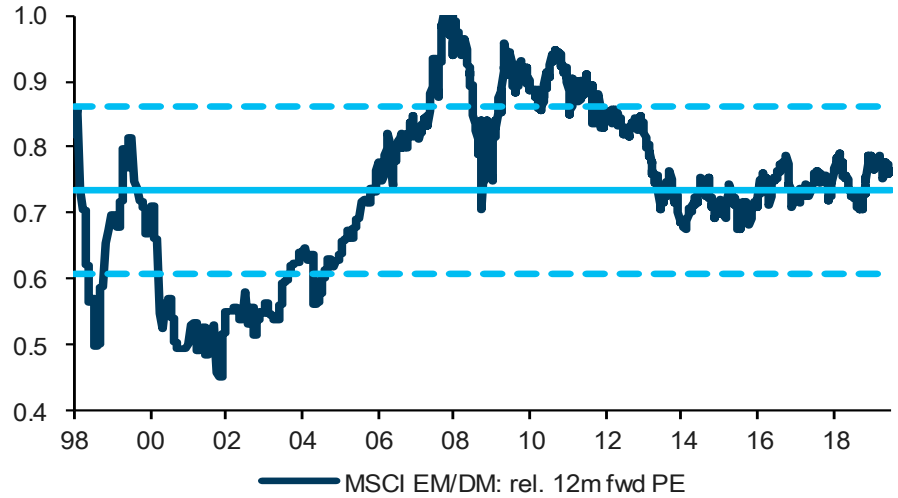
Private debt to GDP has gone up a lot in EM, but also in US



Source: Datastream, World Bank, Haver, Note: EM data only till 2016

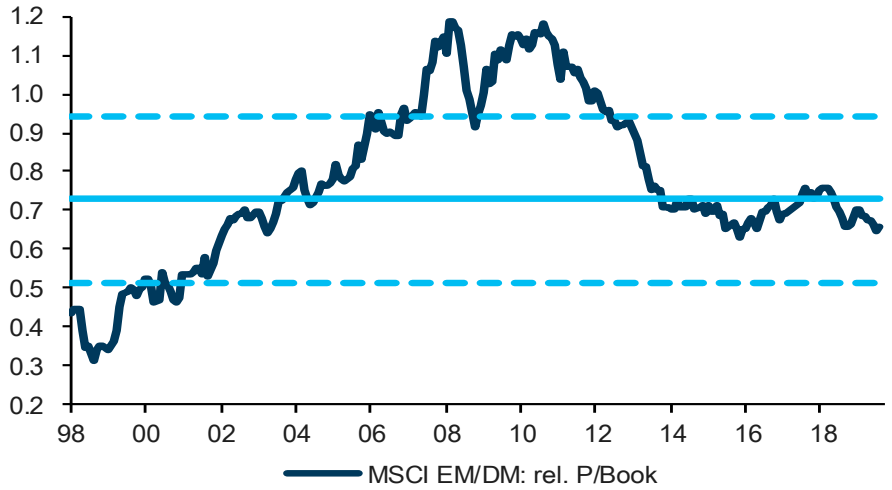
EM valuations are neutral, relative EPS revisions are not improving much

MSCI EM/DM P/E relative is above the historical median



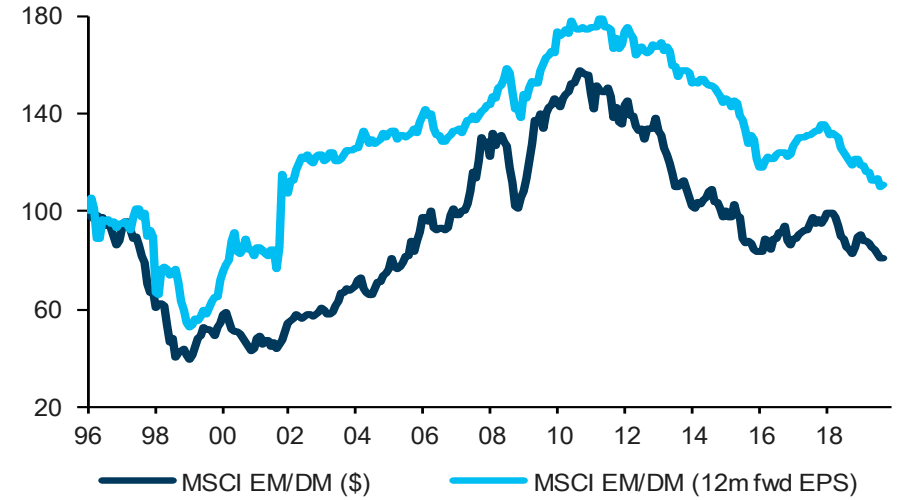
Source: Barclays Research, Datastream, MSCI

MSCI EM/DM P/Book is below the historical median



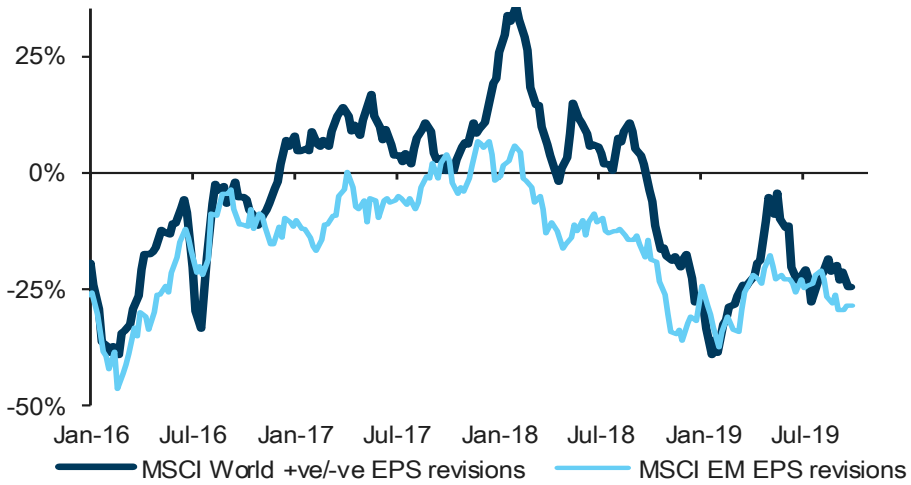
Source: Barclays Research, Datastream, IBES, MSCI

MSCI EM/DM price and EPS relative move in tandem



Source: Barclays Research. Datastream, IBES

EM and DM EPS are both rolling over

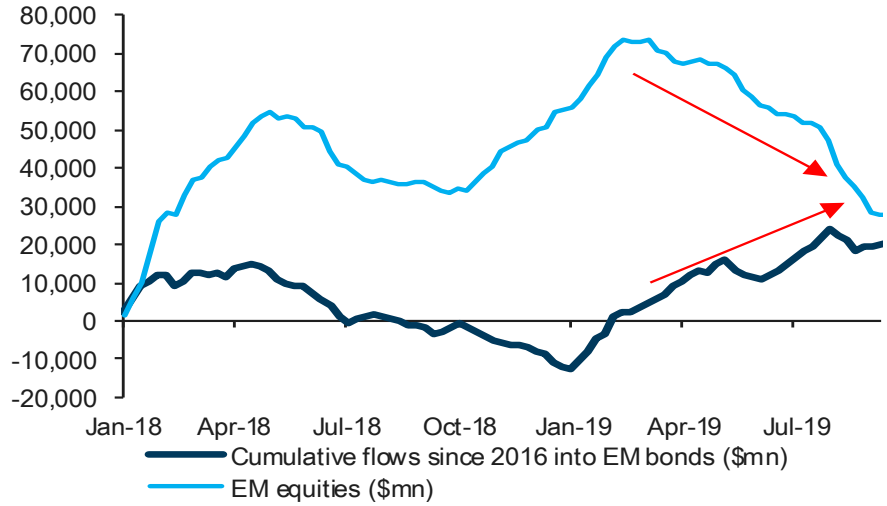


Source: Barclays Research, Datastream, IBES, MSCI

EM $ bonds are in demand, but not equities anymore

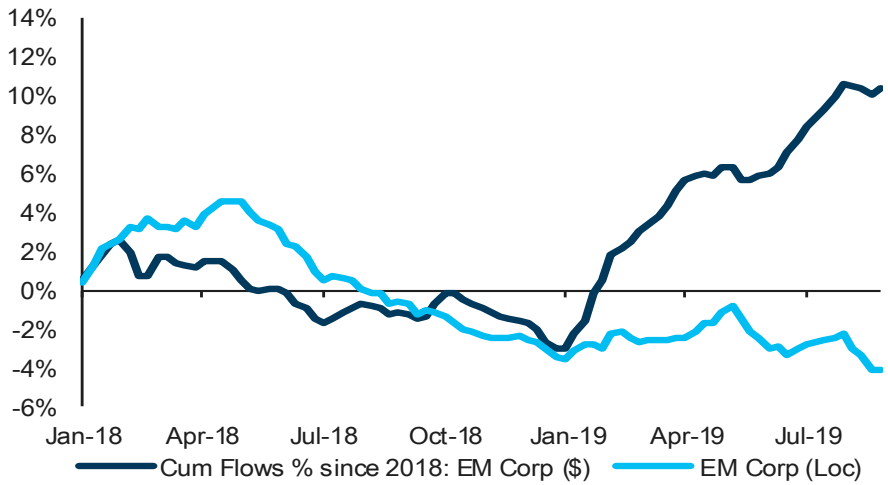
- EM equity flows turned negative in Q2, following the strong momentum seen since the end of Q3'18. However, bond inflows have picked up.
- The relative equity flows between EM and US still look elevated in the historical context, though.
- This could make it vulnerable should we see further trade/tariff escalation but performance has fallen quite a bit already.

EM Equities/Bonds flows are diverging



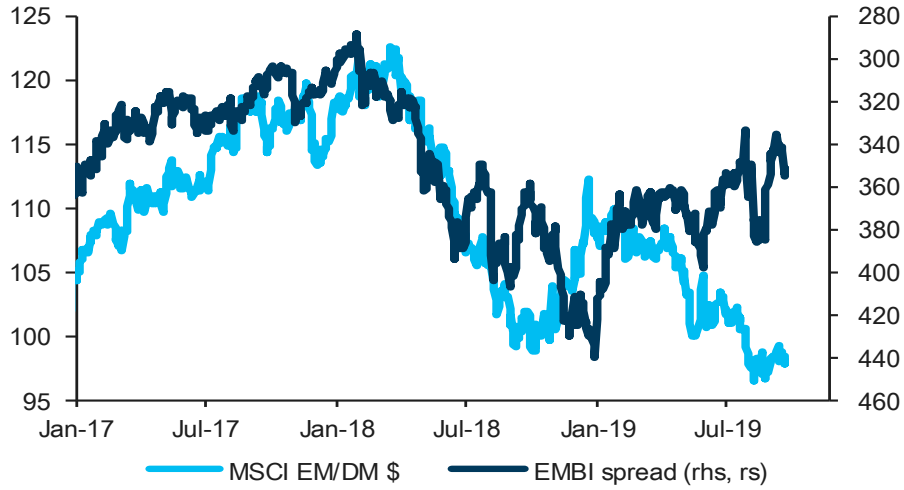
Source: EPFR, Barclays Research

Hard currency EM bonds are seeing inflows, not local bonds



Source: EPFR, Barclays Research

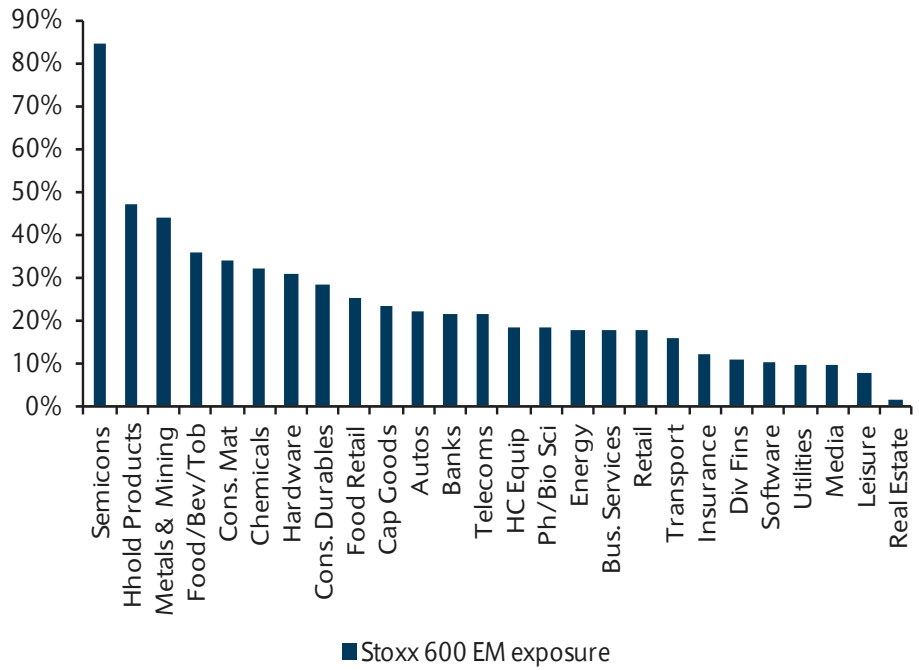
EM equities are lagging the compression in spreads



Source: Bloomberg, Datastream

EM exposure basket

European sectors' exposure to EM



Source: Bloomberg, Worldscope, Barclays Research

Barclays European EM exposure basket (BCEUEREM)

Ticker	Name	Sector	Country	Mcap ($bn)	EM exposure
ADS GY	Adidas	C Disc	Germany	46.1	45%
KER FP	Kering	C Disc	France	68.3	37%
CFR SE	Richemont N	C Disc	Switzerland	45.9	45%
ULVR LN	Unilever (UK)	C Staples	UK	67.8	71%
JMT PL	Jeronimo Martins	C Staples	Portugal	9.2	71%
CCH LN	Coca-Cola Hbc (Cdi)	C Staples	UK	13.1	63%
BN FP	Danone	C Staples	France	54.0	46%
RDSA NA	Royal Dutch Shell A	Energy	Netherlands	156.9	83%
BBVA SQ	BBV.Argentaria	Financials	Spain	48.2	64%
SAN SQ	Banco Santander	Financials	Spain	90.6	55%
MAP SQ	Mapfre	Financials	Spain	9.4	53%
STAN LN	Standard Chartered	Financials	UK	30.5	55%
NMC LN	NMC Health	Health Care	UK	10.5	92%
SAN FP	Sanofi	Health Care	France	108.5	25%
EI FP	Essilor Intl.Cmpg.D Optique	Health Care	France	32.2	26%
BVI FP	Bureau Veritas Intl.	Industrials	France	11.5	27%
ATCOA SS	Atlas Copco 'A'	Industrials	Sweden	24.0	57%
ALFA SS	Alfa Laval	Industrials	Sweden	11.5	26%
ABBN SE	ABB Ltd	Industrials	Switzerland	49.6	37%
SIE GY	Siemens	Industrials	Germany	119.2	29%
ASML NA	ASML Holding	IT	Netherlands	93.5	68%
ERICB SS	Ericsson 'B'	IT	Sweden	24.6	28%
DHER GY	Delivery Hero	IT	Germany	11.0	50%
YAR NO	Yara International	Materials	Norway	12.2	55%
DSM NA	DSM Koninklijke	Materials	Netherlands	19.3	34%
BLT LN	BHP Billiton	Materials	UK	47.3	82%
LHN SE	LafargeHolcim	Materials	Switzerland	30.6	57%
AAL LN	Anglo American	Materials	UK	31.2	51%
TEF SQ	Telefonica	Telecom	Spain	46.4	47%
GAS SQ	Naturgy Energy	Utilities	Spain	27.0	36%

Source: Bloomberg, IBES, Datastream, Barclays Research.
For more information please see our report Hold your nerve, equities still have upside, 30 July 2018.

EM countries scorecard

MSCI EM countries scorecard

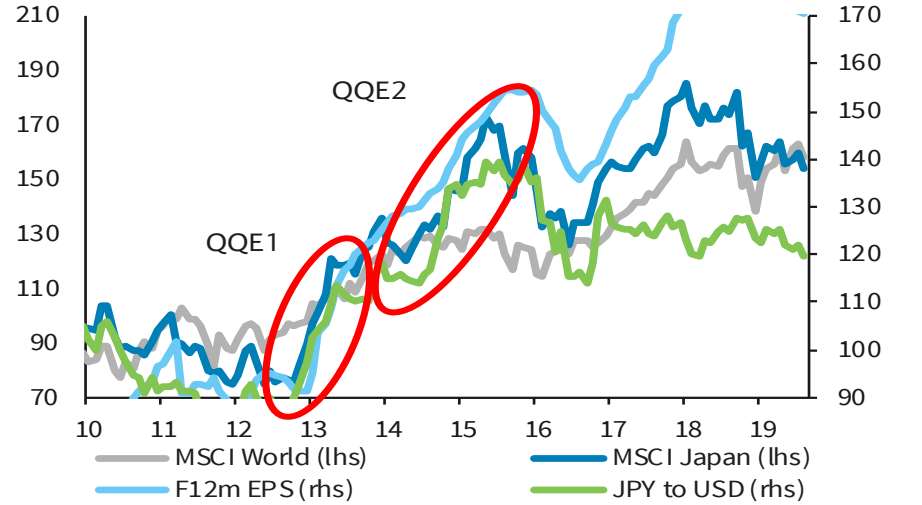
	Overall rank	Price Mom (1,3 & 6m)	P/Book vs 10Y median	Fwd P/E vs 10Y median	Fwd Div Yield	F12m EPS Growth	EPS Mom	ROE
MSCI EM		**-1.8%**	**-2.4%**	**8.1%**	**3.1%**	**10.8%**	**-1.8%**	**11.9%**
Mexico	1	0.1%	-26.5%	-17.7%	3.0%	10.9%	-6.0%	13.3%
South Africa	2	-6.6%	-14.5%	-10.1%	3.3%	15.2%	3.9%	12.1%
Greece	3	2.0%	-1.9%	9.1%	4.5%	16.0%	-1.4%	4.2%
Russia	4	2.1%	8.5%	6.9%	7.4%	0.8%	-2.9%	17.3%
Indonesia	5	-3.9%	-22.5%	6.6%	2.8%	10.9%	-2.2%	15.3%
Philipines	6	-2.7%	-21.3%	-7.5%	1.5%	11.0%	1.0%	11.4%
Taiwan	7	3.3%	-3.1%	13.9%	4.0%	6.7%	0.4%	11.3%
India	8	-1.3%	-15.9%	4.5%	1.5%	21.8%	-5.4%	11.3%
Colombia	9	-4.5%	-14.3%	-20.5%	3.5%	11.2%	-9.7%	11.3%
Hungary	10	-2.8%	1.3%	-10.5%	2.6%	8.2%	-3.8%	15.6%
Brazil	11	-0.2%	35.3%	16.1%	3.0%	12.1%	-4.7%	15.7%
China	12	-3.8%	-1.1%	7.2%	2.8%	14.6%	-3.8%	12.5%
Poland	13	-6.0%	-10.5%	-9.6%	3.3%	13.5%	-5.9%	9.6%
Chile	14	-2.9%	-16.9%	5.8%	3.5%	7.3%	-14.7%	10.8%
Thailand	15	-2.3%	-3.6%	22.3%	2.9%	6.7%	-2.5%	11.5%
Korea	16	0.9%	-21.7%	18.9%	2.5%	5.6%	-4.3%	8.4%

Source: Bloomberg, Worldscope, Barclays Research

Japanese equities – safe haven Yen strength = EPS growth headwind

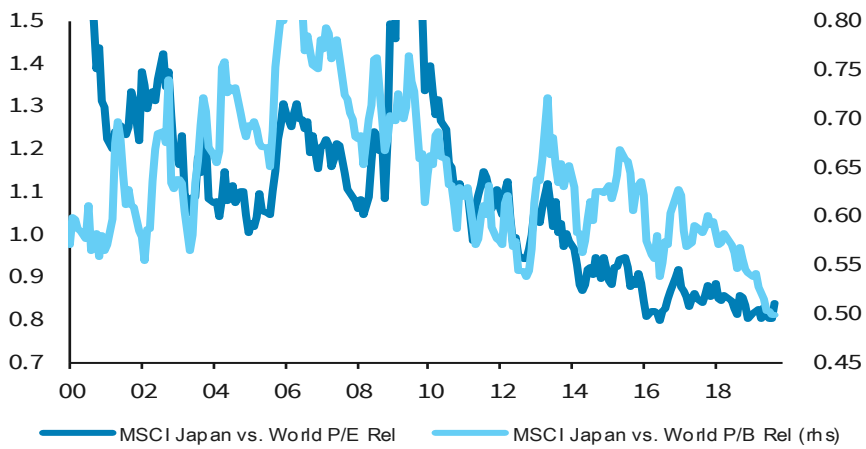
- Japan has enjoyed two periods of significant outperformance since 2012, both of which coincided with Yen depreciation engineered by the BoJ.
- Outperformance was driven by repatriated hard currency earnings being worth more in depreciated Yen.
- Since the last successful depreciation Japanese equities have moved more in line with RoW, while continuing to de-rate vs. RoW.
- Moreover Japanese equities are highly trade/export dependent, without the benefit of being tech leaders.
- Recent Yen strength on safe haven currency moves provide a significant headwind to EPS growth.

MSCI Japan outperformed as the Yen was weakening



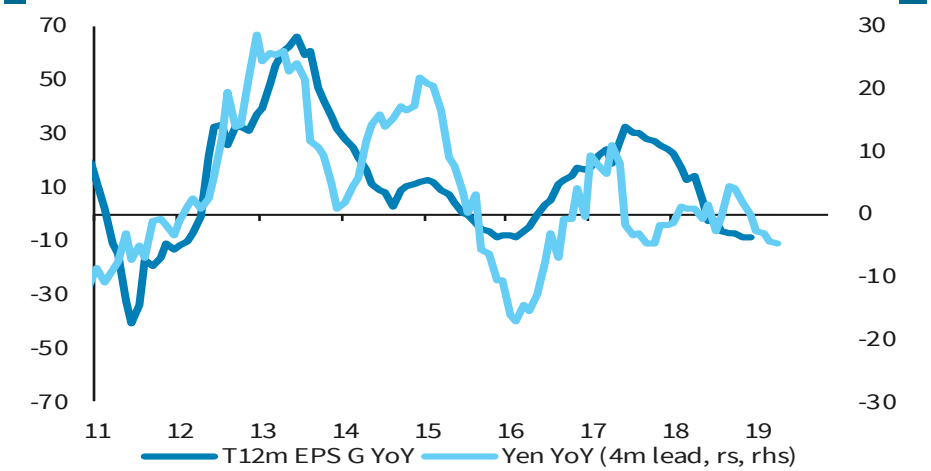
Source: MSCI, IBES, Refinitiv, Barclays Research

Japan continues to de-rate vs. RoW



Source: MSCI, IBES, Refinitiv, Barclays Research

Recent Yen strength is a headwind for EPS growth



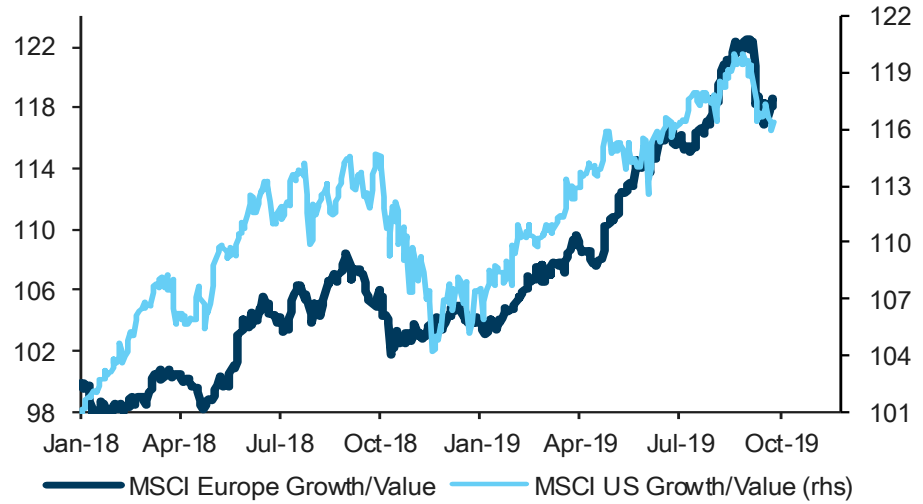
Source: MSCI, IBES, Refinitiv, Barclays Research

Styles & Themes

1. Risk-reward looks more attractive for Value than for Growth & Quality

- Value style has underperformed sharply ytd relative to Growth by 12%. Over the last decade, Value underperformance vs. Growth amounts to nearly 40%.
- Most recently though, Value outperformed in September. Without making a case for a sustained style rotation, we think Value is offering an attractive risk-reward at present, somewhat disconnected from the broader market direction.
- We believe that Value could catch on the upside if stocks keep rallying, but could also be less vulnerable to profit taking than Growth if the market sells off again.

Growth underperformed in H2'18 but rebounded ytd

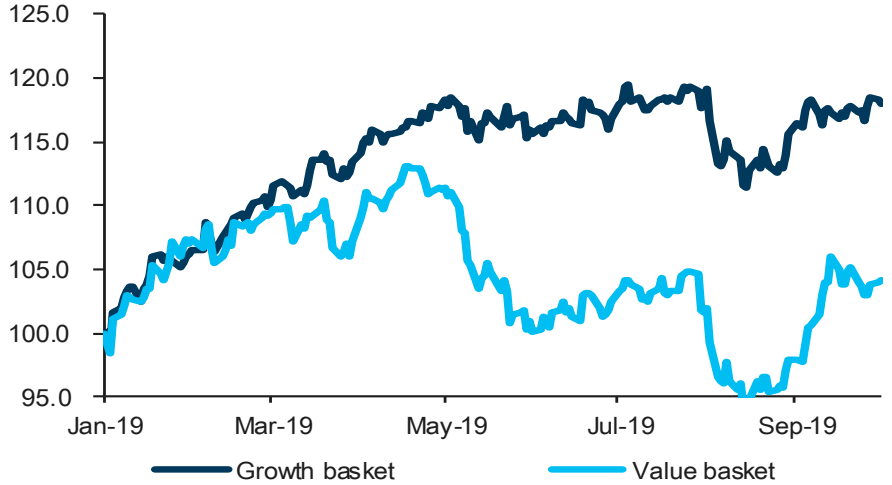


Source: Datastream

Value has underperformed Growth continuously since '10

Source: Datastream

Value has underperformed Growth by 13% ytd

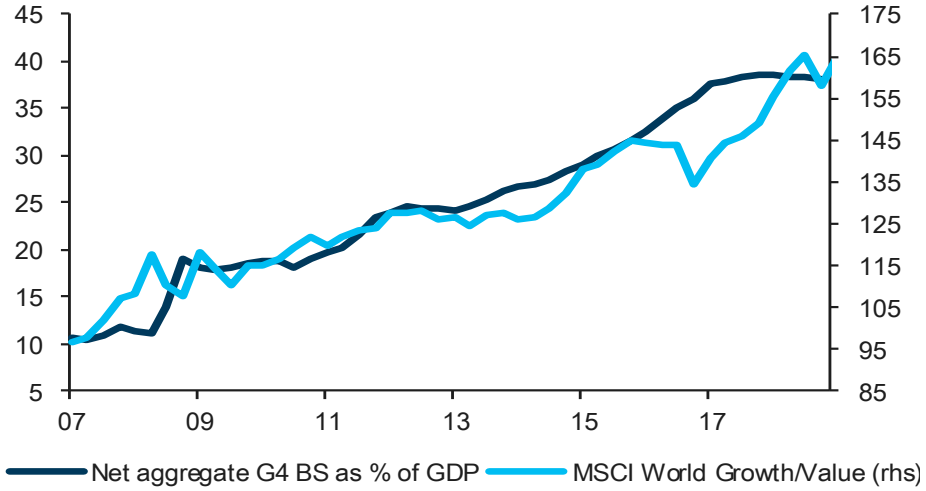


Source: Bloomberg, Barclays Research

The direction of bond yields is the key driver of the Value/Growth trade

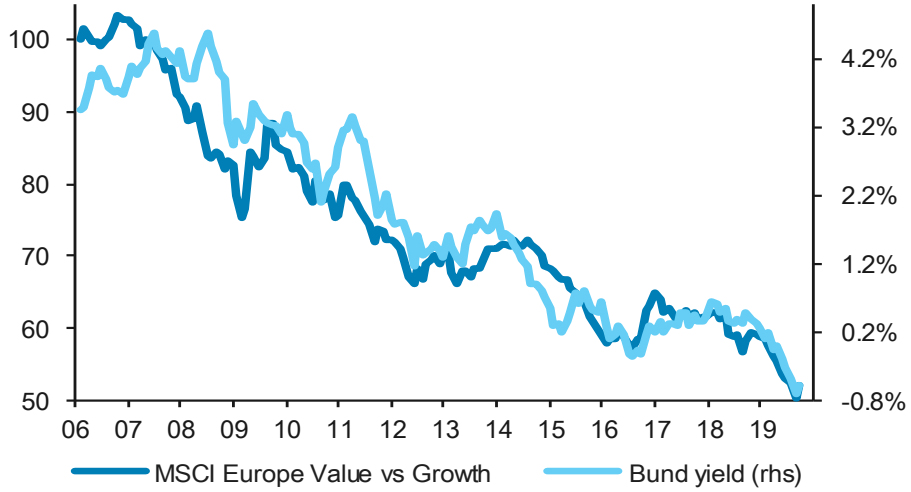
- The bond market is a key driver of the Value/Growth trade, and the ytd Value underperformance almost perfectly matched the compression in yields.
- The current mix of weak growth and subdued inflation likely provides a fundamental cap to bond yields, and thus to Value.
- We believe however that it might not take much of a stabilisation in bond yields for Value to find a floor vs. Growth, following its extreme de-rating.

Growth' style has been a key beneficiary of the asset reflation trade



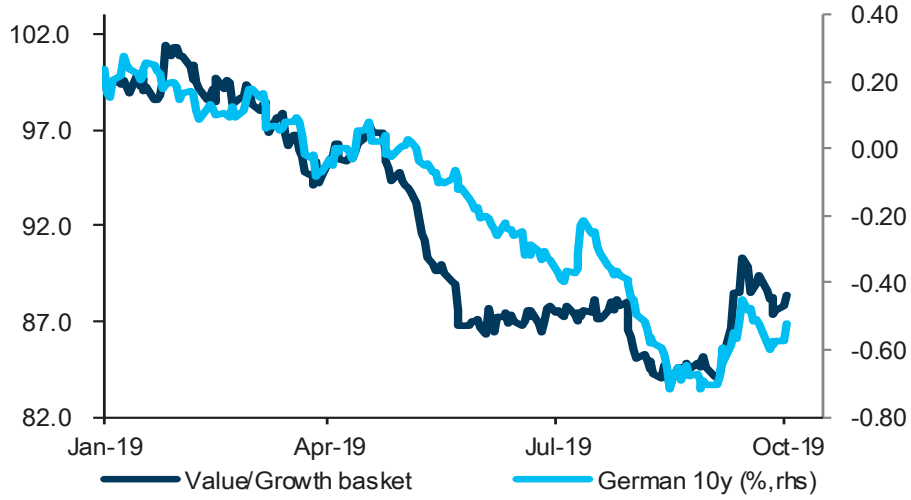
Source: Datastream, Bloomberg, Barclays Research

The Value/Growth trade is highly dependent on bond yield direction over the long run



Source: Datastream

Value/Growth baskets rolled over along with bond yields

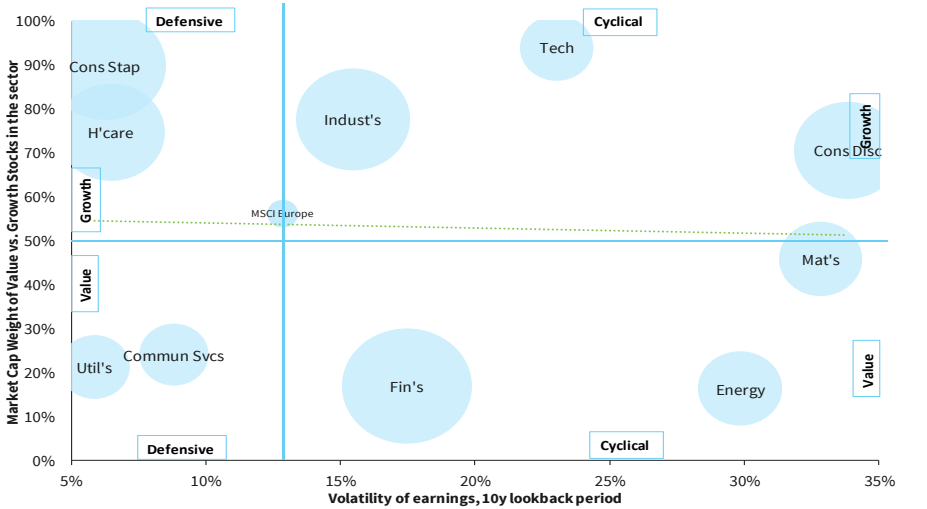


Source: Bloomberg

Value vs. Growth is not Cyclical vs. Defensive in Europe

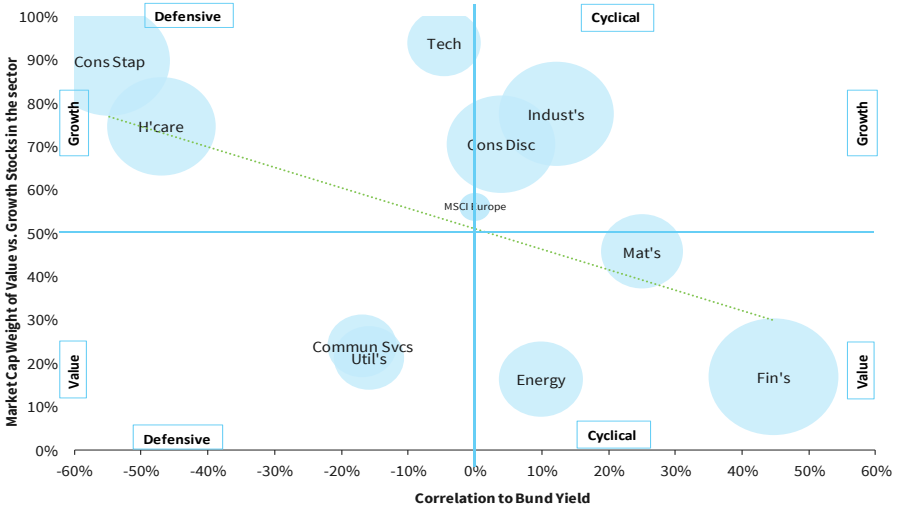
- Mapping the market cap weight of Growth & Value stocks in each Level 1 sector vs. that sector's cyclicality of earnings gives a wide dispersion with little obvious relationship between Value/Growth and cyclicality.
- The four main quadrants are dominated by:
  - Defensive-Growth is Staples & Healthcare
  - Cyclical-Growth is Industrials, Tech & Cons Disc
  - Defensive-Value is Utilities and Telco
  - Cyclical-Value is Materials, Energy and Fin's
- However within each Level 1 sector there can be wide disparities:
  - Cons Disc is Luxury Goods (Cyclical-Growth) and Autos (Cyclical-Value), which behave very differently.
  - Financials is Insurance (Defensive-Value) and Banks (Cyclical-Value).
- When we plot the sectors by Value/Growth vs. Bond yields, we see large weightings towards the extremes of Defensive-Growth and Cyclical-Value making Value vs. Growth behave like a bond yield.
- This argues for more nuance when constructing a portfolio with Value/Growth, Cyclical/Defensive biases at the sector level.

Europe Value/Growth vs. earnings cyclicality



Source: Refinitiv, Barclays Research

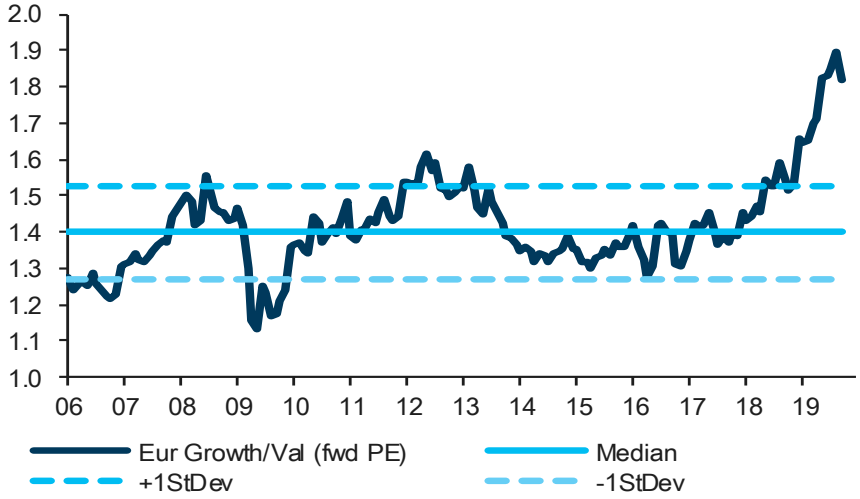
Europe Value/Growth correlation to bund yield



Source: Refinitiv, Barclays Research

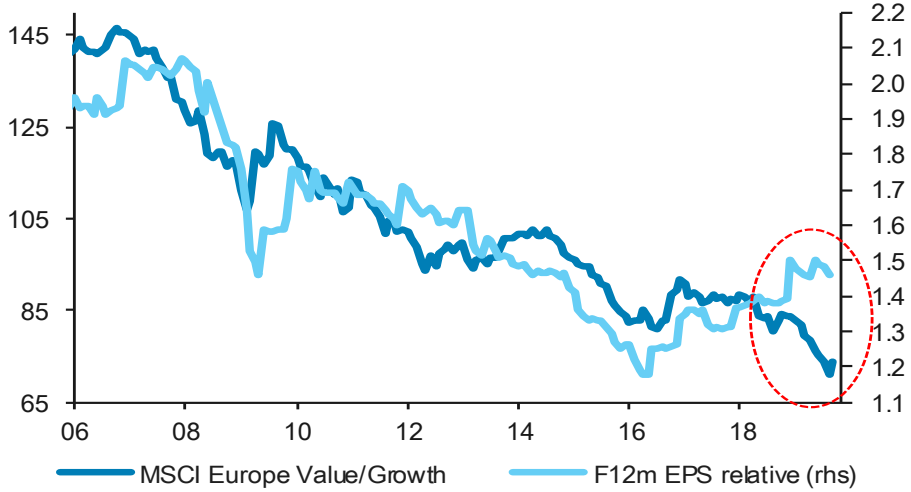
Value/Growth valuation dispersion is still near extreme

Growth P/E vs. Value is at record highs



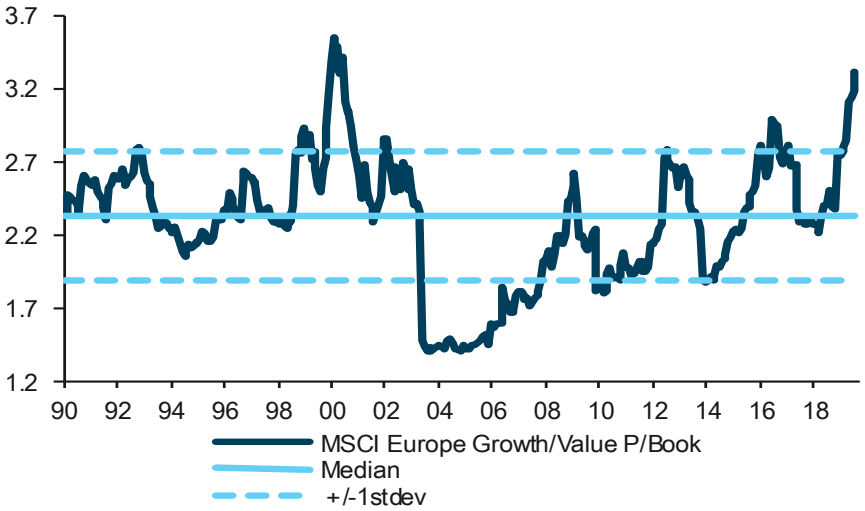
Source: IBES

Value/Growth performance is undershooting its relative EPS momentum



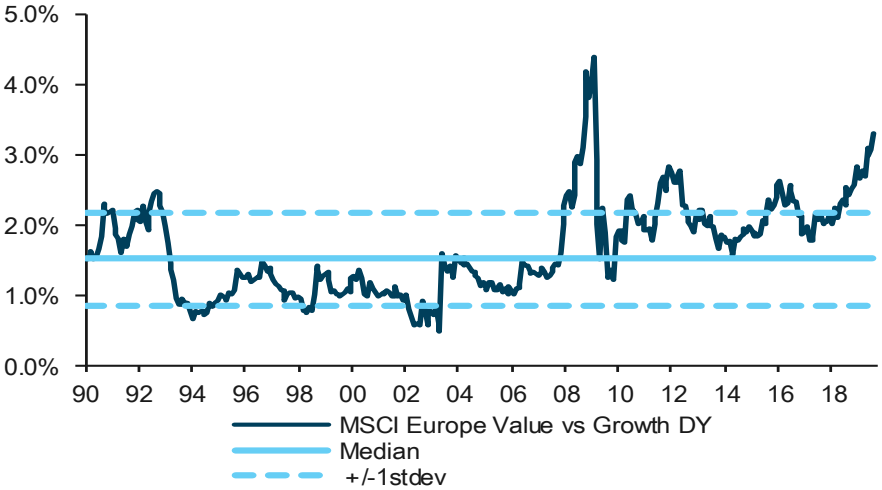
Source: Datastream, IBES

Growth also looks stretched vs. Value on P/Book metric



Source: Datastream

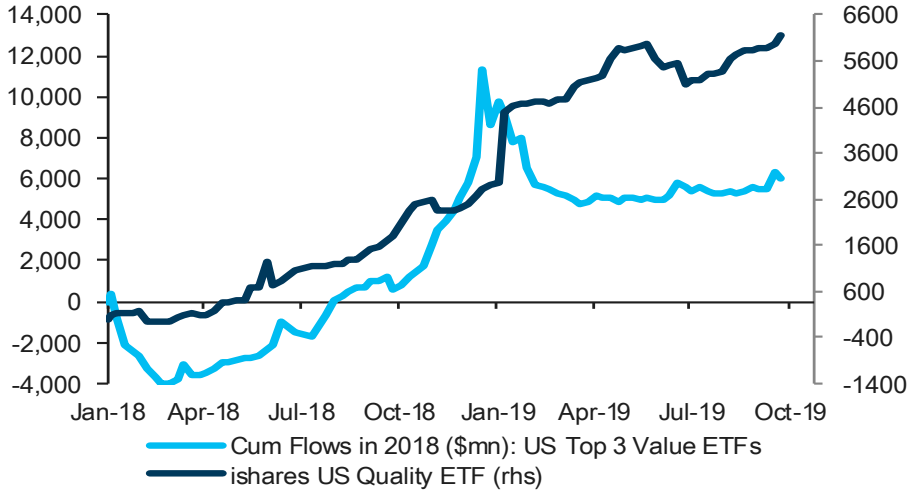
Value dividend yield is more than double that of Growth



Source: Datastream

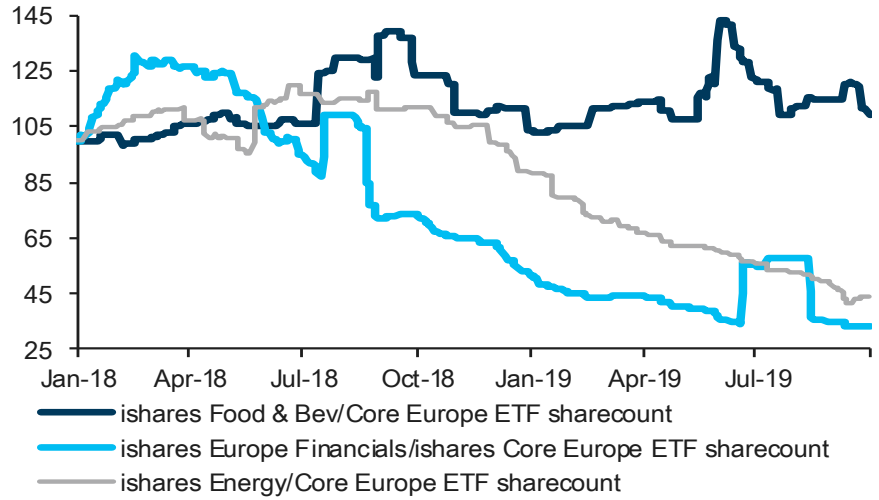
Growth/Quality stocks are well owned

Quality ETFs are in demand



Source: Bloomberg, Barclays Research

Staples vs Financials ETFs flows – mind the gap



Source: Bloomberg, Barclays Research

MSCI Europe Value and Growth weightings by sector

	Sector	Value	Growth	Value-Growth
Value	Financials	31%	3%	29%
	Energy	14%	1%	12%
	Utilities	10%	1%	9%
	Comm Svcs	10%	2%	7%
	Materials	8%	6%	2%
	Real Estate	2%	0%	2%
Growth	Healthcare	7%	15%	-9%
	Cons Disc	8%	15%	-7%
	IT	1%	10%	-9%
	Industrials	7%	18%	-12%
	Cons Stap	4%	28%	-24%

Source: Datastream

MSCI USA Value and Growth weightings by sector

	Sector	Value	Growth	Value-Growth
Value	Financials	20.3%	6.0%	14.3%
	Cons Disc	4.0%	16.6%	-12.6%
	Energy	8.0%	1.0%	7.0%
	Utilities	6.9%	0.1%	6.9%
	Comm Svcs	8.7%	13.2%	-4.6%
	Real Estate	4.9%	2.2%	2.6%
	Materials	2.6%	2.7%	-0.1%
	Healthcare	13.9%	10.3%	3.6%
Growth	Industrials	6.9%	10.6%	-3.7%
	Cons Stap	14.4%	2.7%	11.7%
	IT	9.4%	34.5%	-25.1%

Source: Datastream

Growth and Value baskets

- Our European Growth (**BCEUGROW**) and Value (**BCEUVALO**) baskets are sector-neutral.

Barclays European Growth basket (BCEUGROW)

Ticker	Name	Sector	Country	Mcap ($bn)	P/B	EPS CAGR 2017-20
ADS GY	ADIDAS	CONS DISC	GERMANY	60.2	8.3	13.2%
BVI FP	BUREAU VERITAS	INDUSTRIALS	FRANCE	10.6	9.6	8.3%
CABK SQ	CAIXABANK	FINANCIALS	SPAIN	18.1	0.7	6.0%
CHR DC	CHRISTIAN HANSEN HOLDI	MATERIALS	DENMARK	14.5	16.6	12.6%
COLOB DC	COLOPLAST B	HEALTHCARE	DENMARK	24.2	24.5	11.1%
DB1 GY	DEUTSCHE BOERSE	FINANCIALS	GERMANY	27.2	4.8	9.3%
DWNI GY	DEUTSCHE WOHNEN BR.SI	REAL ESTA	GERMANY	14.5	1.1	7.3%
EMSN SE	EMS-CHEMIE 'N'	MATERIALS	SWITZERLAND	14.6	8.9	3.7%
EOAN GY	E ON N	UTILITIES	GERMANY	24.7	3.7	3.8%
EQNR NO	EQUINOR	ENERGY	NORWAY	65.9	1.5	4.5%
GALP PL	GALP ENERGIA SGPS	ENERGY	PORTUGAL	12.9	2.5	9.2%
GEBN SE	GEBERIT 'R'	INDUSTRIALS	SWITZERLAND	16.9	9.3	5.5%
HEIA NA	HEINEKEN	CONS STAP	NETHERLANDS	63.9	3.9	7.7%
HL/ LN	HARGREAVES LANSDOWN	FINANCIALS	UNITED KINGDOM	11.5	22.4	10.8%
ITRK LN	INTERTEK GROUP	INDUSTRIALS	UNITED KINGDOM	11.2	10.1	6.6%
JMT PL	JERONIMO MARTINS	CONS STAP	PORTUGAL	10.4	5.2	9.1%
KNIN SE	KUEHNE UND NAGEL INTEI	INDUSTRIALS	SWITZERLAND	16.4	7.0	6.2%
KPN NA	KPN KON	COMM SERV	NETHERLANDS	13.6	6.2	12.1%
KYG ID	KERRY GROUP 'A'	CONS STAP	IRELAND	21.1	4.6	9.7%
MONC IM	MONCLER	CONS DISC	ITALY	9.9	8.0	10.5%
NOVOB DC	NOVO NORDISK 'B'	HEALTHCARE	DENMARK	120.2	15.0	9.2%
NZYMB DC	NOVOZYMES B	MATERIALS	DENMARK	13.8	7.7	5.6%
PGHN SE	PARTNERS GROUP HOLDIN	FINANCIALS	SWITZERLAND	19.1	9.5	8.9%
PRU LN	PRUDENTIAL	FINANCIALS	UNITED KINGDOM	53.8	2.4	5.2%
RCO FP	REMY COINTREAU	CONS STAP	FRANCE	6.8	4.4	11.9%
REL LN	RELX	INDUSTRIALS	UNITED KINGDOM	46.8	15.8	6.8%
RMS FP	HERMES INTL.	CONS DISC	FRANCE	72.9	11.6	9.2%
SGSN SE	SGS 'N'	INDUSTRIALS	SWITZERLAND	19.9	11.7	6.8%
TEMN SE	TEMENOS N	INFO TECH	SWITZERLAND	12.6	41.5	17.1%
UBI FP	UBISOFT ENTERTAINMENT	COMM SERV	FRANCE	9.2	9.1	9.5%

Source: Bloomberg, IBES, Datastream, Barclays Research. For more information please see our report Hold your nerve, equities still have upside, 30 July 2018.

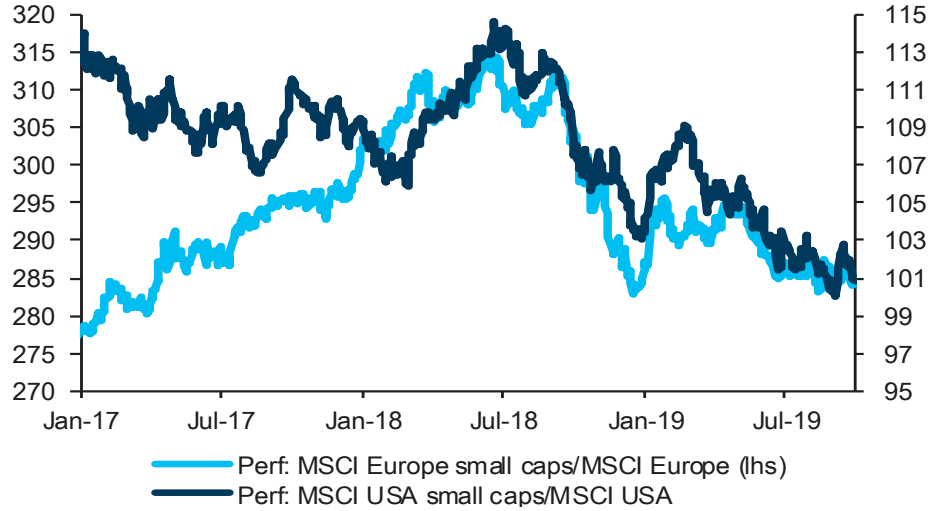
Barclays European Value basket (BCEUVALO)

Ticker	Name	Sector	Country	Mcap ($bn)	P/B
AAL LN	ANGLO AMERICAN	MATERIALS	UNITED KINGDOM	35.8	1.0
ACA FP	CREDIT AGRICOLE	FINANCIALS	FRANCE	34.0	0.5
AD NA	KONINKLIJKE AHOLD DELH	CONS STAP	NETHERLANDS	27.3	1.6
BMW GY	BMW	CONS DISC	GERMANY	45.8	0.7
CA FP	CARREFOUR	CONS STAP	FRANCE	15.2	1.4
CO FP	CASINO GUICHARD-P	CONS STAP	FRANCE	4.0	0.6
DBK GY	DEUTSCHE BANK	FINANCIALS	GERMANY	14.0	0.2
EDF FP	EDF	UTILITIES	FRANCE	42.9	0.9
EN FP	BOUYGUES	INDUSTRIALS	FRANCE	13.4	1.2
ENI IM	ENI	ENERGY	ITALY	57.6	1.0
ERICB SS	ERICSSON B	INFO TECH	SWEDEN	32.5	3.5
GLE FP	SOCIETE GENERALE	FINANCIALS	FRANCE	20.4	0.3
GLEN LN	GLENCORE	MATERIALS	UNITED KINGDOM	46.8	0.7
HEI GY	HEIDELBERGCEMENT	MATERIALS	GERMANY	15.2	0.9
KGF LN	KINGFISHER	CONS DISC	UNITED KINGDOM	5.7	0.7
LAND LN	LAND SECURITIES GROUP	REAL ESTA	UNITED KINGDOM	8.0	0.6
LHA GY	DEUTSCHE LUFTHANSA	INDUSTRIALS	GERMANY	9.5	0.9
MAERSKB DC	A P MOLLER MAERSK B	INDUSTRIALS	DENMARK	22.4	0.8
NN NA	NN GROUP	FINANCIALS	NETHERLANDS	13.9	0.5
NOKIA FH	NOKIA	INFO TECH	FINLAND	27.9	1.6
REP SQ	REPSOL YPF	ENERGY	SPAIN	25.8	0.7
SAN FP	SANOFI	HEALTHCARE	FRANCE	109.1	1.6
SBRY LN	SAINSBURY J	CONS STAP	UNITED KINGDOM	5.6	0.6
SGO FP	SAINT GOBAIN	INDUSTRIALS	FRANCE	20.2	1.0
SGRE SQ	SIEMENS GAMESA RENEW.	INDUSTRIALS	SPAIN	11.2	1.7
SN/ LN	SMITH & NEPHEW	HEALTHCARE	UNITED KINGDOM	18.8	1.5
STAN LN	STANDARD CHARTERED	FINANCIALS	UNITED KINGDOM	29.7	0.6
TIT IM	TELECOM ITALIA	COMM SERV	ITALY	10.9	0.5
UHR SE	THE SWATCH GROUP	CONS DISC	SWITZERLAND	14.6	1.2

Source: Bloomberg, IBES, Datastream, Barclays Research. For more information please see our report Hold your nerve, equities still have upside, 30 July 2018.

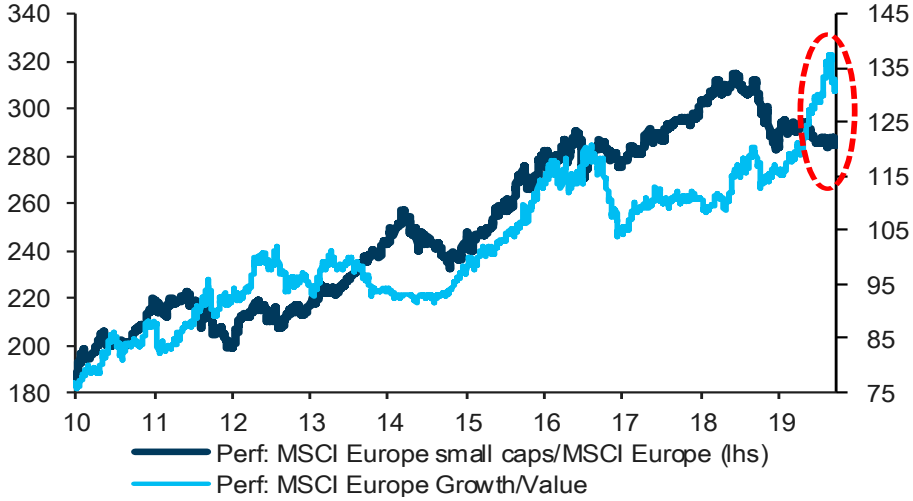
Small/Large caps tend to move with Growth/Value style but decoupled ytd

Small caps have underperformed ytd



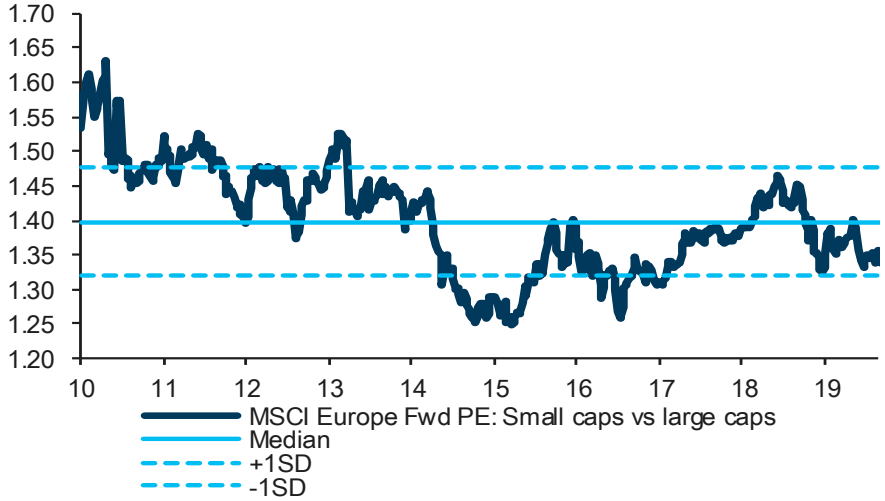
Source: Datastream

Small/Large opened a gap with Growth/Value



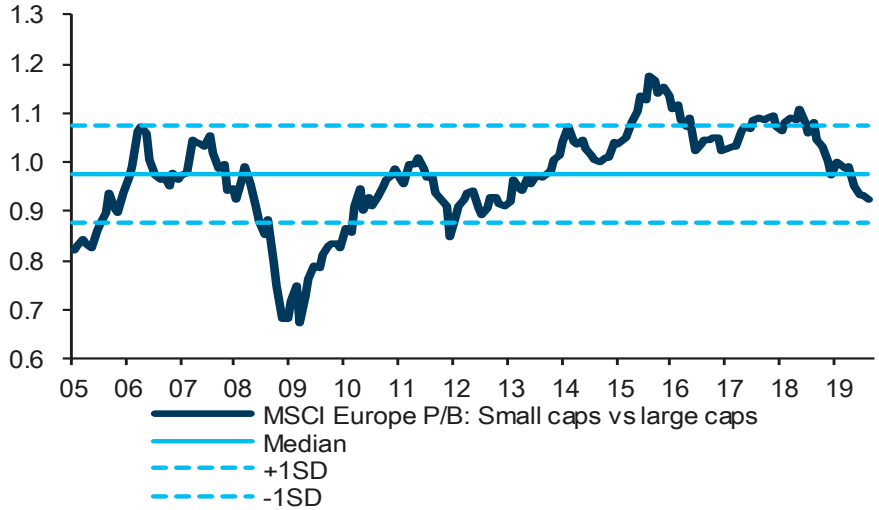
Source: Datastream

European small caps P/E have de-rated and looks cheap



Source: Datastream

Small/Large P/Book relative has lowered recently



Source: Datastream

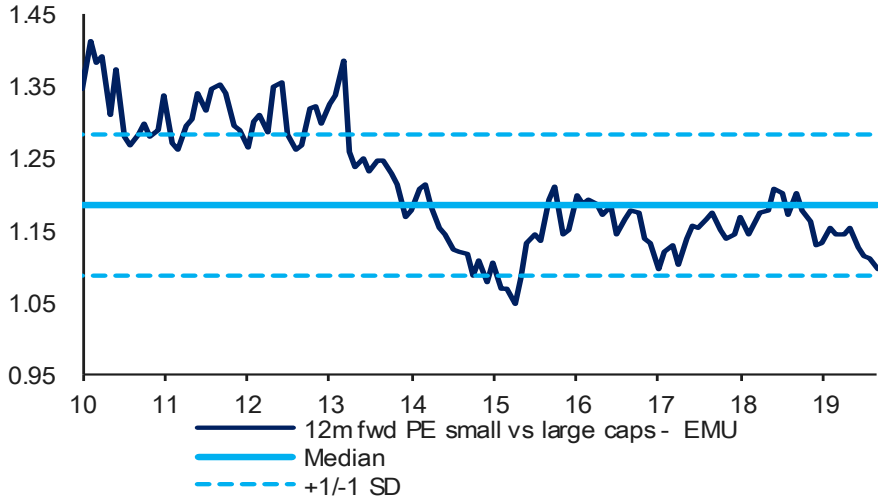
Resilient domestic demand should support small caps in Eurozone, but liquidity is problematic

- Small caps, which tend to be more domestically-exposed than large ones, underperformed in 2018 and again ytd, despite resilient domestic spending.
- Reducing market liquidity appears to be hurting the 'investability' of the SMID space.

Eurozone small caps underperformed since 2018

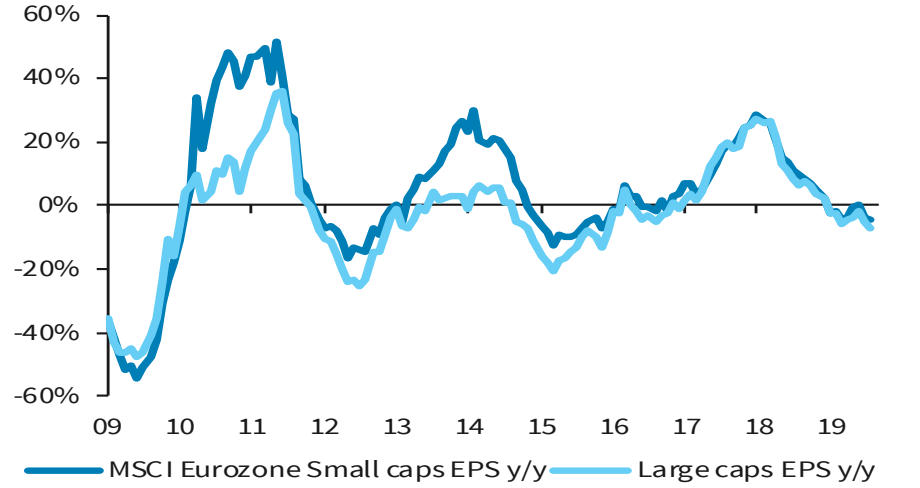
Source: Datastream

Small caps valuations are not demanding…



Source: Datastream

…and their relative EPS momentum has been resilient



Source: Datastream

2. Trade war

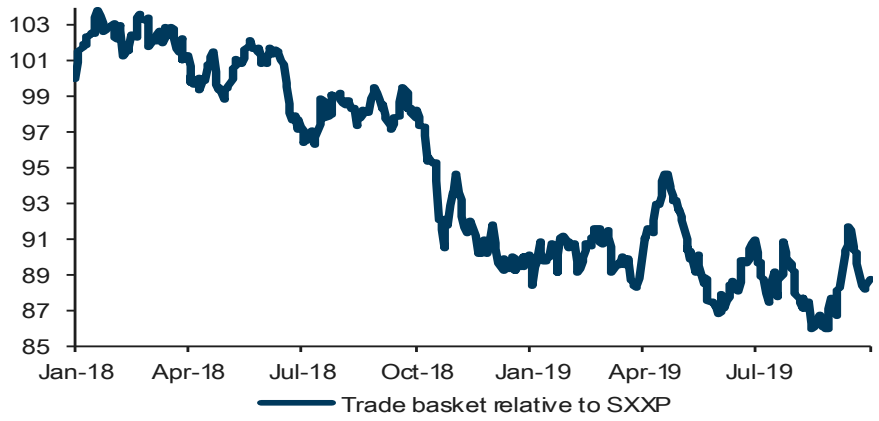
- We have constructed a basket of the European stocks that could be the most sensitive to the trade war between US and China/Europe. It is available on Bloomberg as **BCEUTRAD**.
- The basket has been generally underperforming since 2018 as the trade war took effect and intensified but outperformed most recently in Sep as hopes increased of talks resuming between US & China

Barclays European tariffs basket (BCEUTRAD)

Ticker	Name	Sector	Country	Mcap ($bn)
DAI GY	Daimler	C Disc	Germany	74.1
EO FP	Faurecia	C Disc	France	9.5
PHIA NA	Philips Eltn.	Health Care	Netherlands	41.9
ABBN SE	ABB Ltd N	Industrials	Switzerland	49.3
AIR FP	Airbus	Industrials	France	99.2
ALFA SS	Alfa Laval	Industrials	Sweden	11.6
ASSAB SS	Assa Abloy 'B'	Industrials	Sweden	21.0
ATCOA SS	Atlas Copco 'A'	Industrials	Sweden	23.9
EN FP	Bouygues	Industrials	France	15.8
CNHI IM	CNH Industrial	Industrials	Italy	15.8
SGO FP	Saint Gobain	Industrials	France	23.9
SAND SS	Sandvik	Industrials	Sweden	22.7
SU FP	Schneider Elec SE	Industrials	France	46.4
SIE GY	Siemens	Industrials	Germany	118.9
SKFB SS	SKF 'B'	Industrials	Sweden	8.5
WRT1V FH	Wartsila	Industrials	Finland	12.6
IFX GY	Infineon Tech	IT	Germany	30.1
STM IM	STMicro	IT	France	20.3
AI FP	Air Liquide	Materials	France	55.3
AKZA NA	Akzo Nobel	Materials	Netherlands	23.3
AKE FP	Arkema	Materials	France	9.4
BAS GY	BASF	Materials	Germany	90.7
1COV GY	Covestro	Materials	Germany	19.4
EVK GY	Evonik Industries	Materials	Germany	17.3
LHN SE	Lafargeholcim	Materials	Switzerland	29.8
SIKA SE	Sika	Materials	Switzerland	21.9
SOLB BB	Solvay	Materials	Belgium	13.7
TKA GY	thyssenkrupp	Materials	Germany	17.0
TEF SQ	Telefonica	Telecom	Spain	46.2

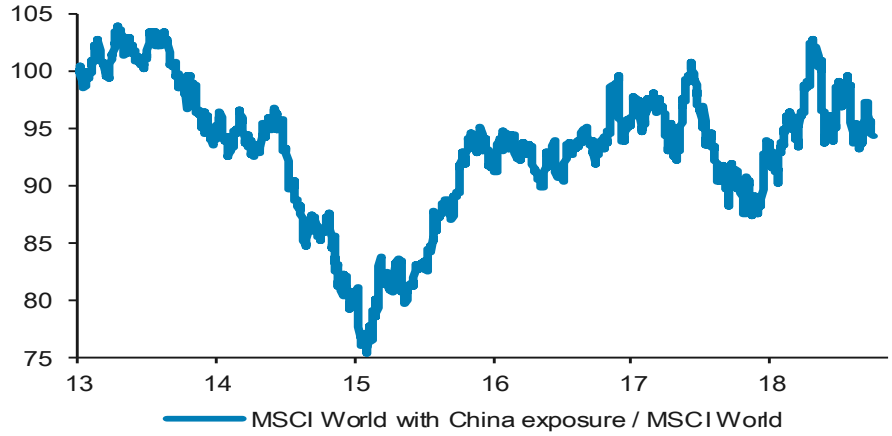
Source: Bloomberg, IBES, Datastream, Barclays Research.
For more information please see our report Hold your nerve, equities still have upside, 30 July 2018.

Our trade basket has outperformed in September



Source: Barclays, Datastream, Bloomberg

Stocks exposed to China moved sideways in Sep



Source: Bloomberg

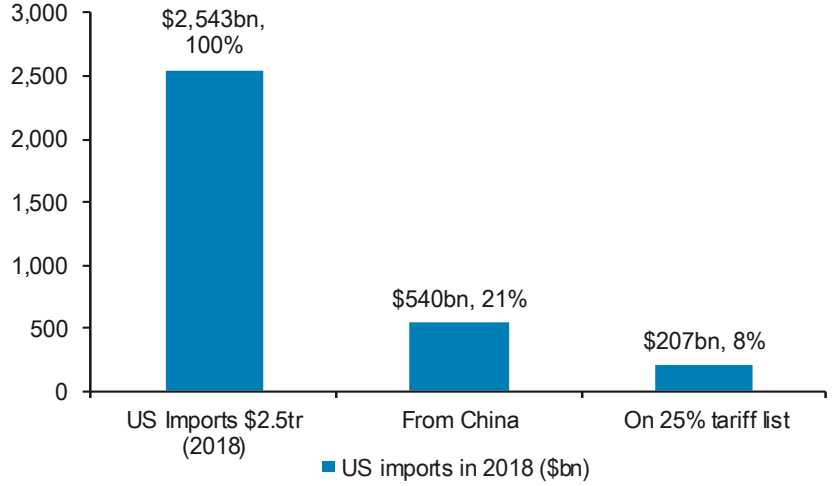
Impact of tariffs on European sectors

Rank	Goods affected	$bn	Stock/Sector impact
Hardware			
1	Telecommunications Equipment (Note: excludes telephone sets & mobiles)	20	European names have already shifted almost all US-bound production out of China, to avoid the impact of tariffs. If mobile phones were to be included, this would impact an additional $43bn of imports.
2	Computer Parts & Accessories	17	Extended supply chains make it had to evaluate a specific impact, but Broadline chip suppliers are likely to have exposure here.
6	Data Processing Units & Peripherals (Note: excludes laptops)	9.4	This is about 50% hard-drives. If laptops were to be included, that would impact a further $37bn of imports.
Autos			
4	Parts for Road Vehicles	11	Autos Suppliers and OEMs would be largely unaffected, as they do not tend to import parts from China for their US-manufactured goods.
15	New Rubber Tyres	2.3	Higher tariffs on Asian-imported tyres could actually be considered a good thing for US and European tyre manufacturers.
			Note: more significant related concerns for European OEMs would be: (1) retaliation from China; (2) Chinese consumer slowdown; and (3) potential tariffs on European imports.
Capital Goods			
9	Electrical Transformers / Static Converters	5.5	More likely to affect the component suppliers, rather than end-product companies, as manufacturers tend to assemble in the US, for the US. Tariffs could be inflationary, as suppliers would ideally pass on the higher costs. This would be tough to do for commoditised goods, like ball-bearings. We could see some supply-chain disruption and companies looking to relocate production.
10	Wires / Cabling	3.5	
12	Taps / Valves (Note: certain exclusions)	2.9	
Consumer Staples			
14	Plastic Packaging	2.7	This could be many types of plastic packaging, but would include food and beverage packaging. Companies are likely to pass higher costs on to consumers.
			Note: Food/Beverages: certain food and beverage products are included in the tariffs. Individually, they make up only a small proportion of the overall $-value of goods in scope. By amalgamating all food and beverage items imported, this totals around $5.8bn. Cosmetic goods: around $1.6bn of cosmetic imports would be subject to tariffs.
Consumer Discretionary			
3	Furniture (other than seating/bedding)	13	Items are largely consumer discretionary products. If importers are able to pass tariffs on, this would most-impact US consumers.
5	Seats	9.6	
7	Electrical Lighting	7.8	
8	Suitcases & Bags	6.4	
11	Base Metal Articles for Furniture	2.9	
13	Plastic Floor Coverings	2.9	

Source: Barclays Research

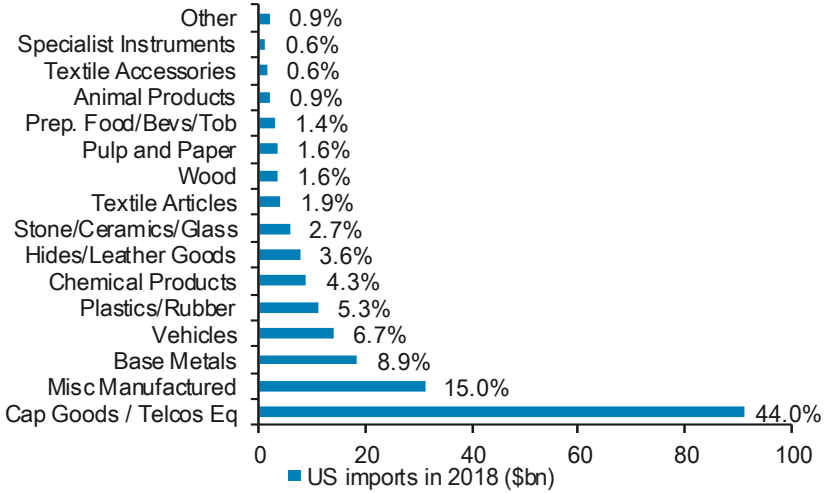
Telcos and computer hardware make up the biggest volume of affected goods

The US imported $540bn of goods from China in 2018, of which $207bn are impacted by the 25% tariff hike



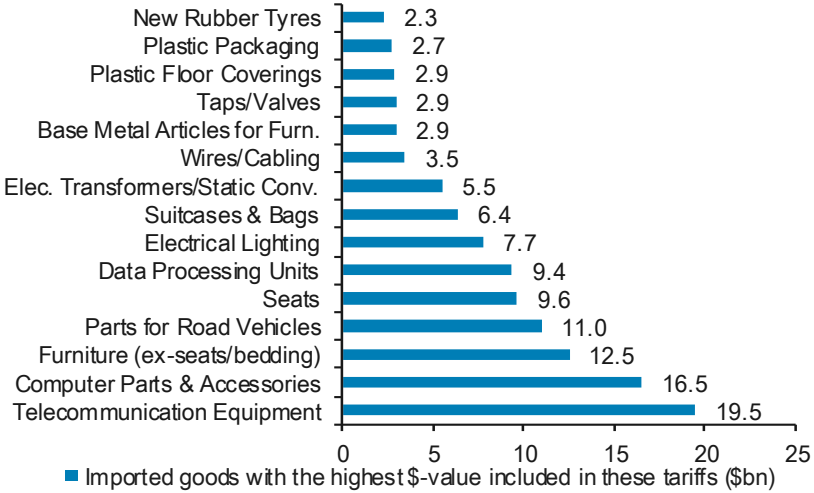
Source: US International Trade Commission, Barclays Research.

44% of the $207bn is Cap Goods/Telcos Equipment



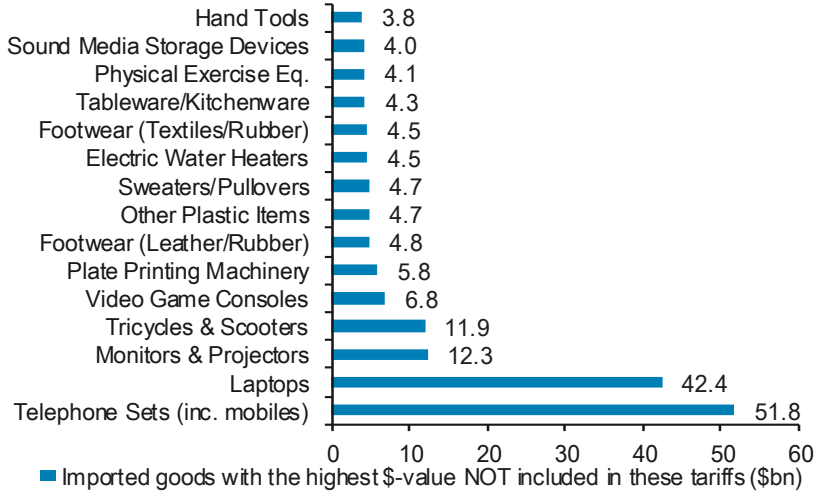
Source: US International Trade Commission, Barclays Research.

At a more granular level, these are the goods with the highest $-value affected



Source: US International Trade Commission, Barclays Research.

Originally not affected, these goods are on the tariff list for Sept (phones/laptops/consoles have a reprieve till Dec)

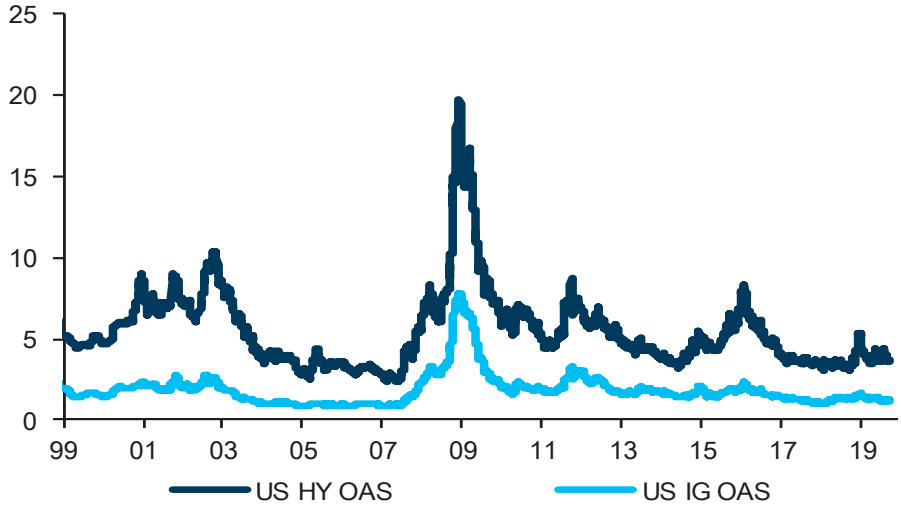


Source: US International Trade Commission, Barclays Research.

3. Corporate Leverage

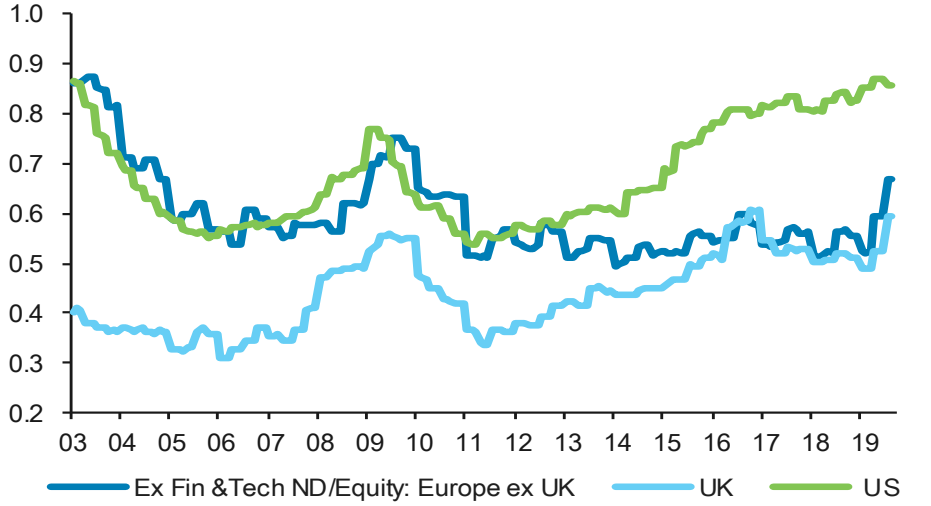
- Credit fundamentals remain generally supportive. B/S leverage has increased in the US, but not in Europe.
- Debt affordability remains elevated, and the cautious central banks should continue to keep credit spreads in a tight range.

Corporate spreads have tightened ytd



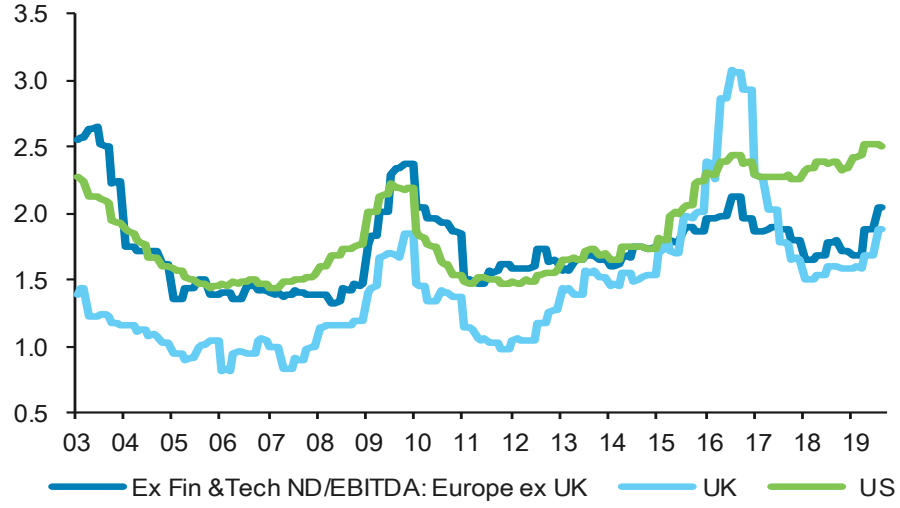
Source: Bloomberg. Barclays Research

Net Debt/Equity is looking stretched in the US and the UK



Source: Datastream, Barclays Research

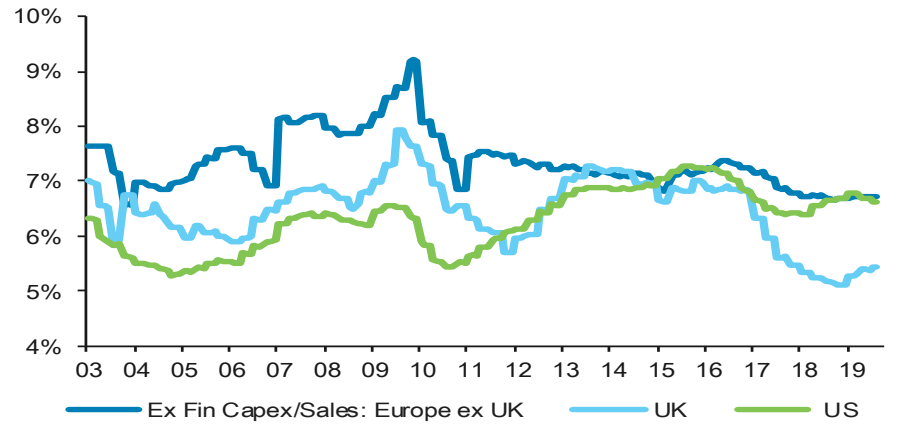
Net Debt/EBITDA is more elevated in the US than in Europe



Source: Datastream, Barclays Research

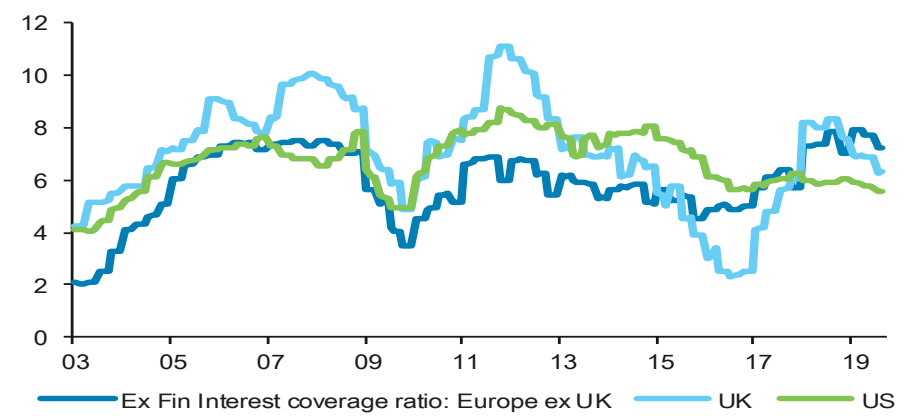
US corporate balance sheets are more leveraged than European ones

Capex to Sales for US and Europe



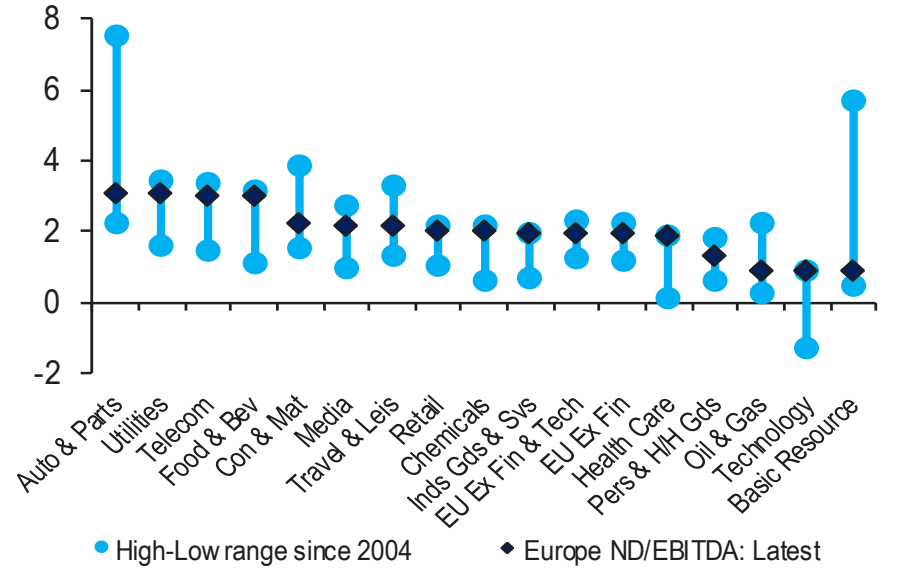
Source: Datastream

Interest coverage remains elevated for Europe



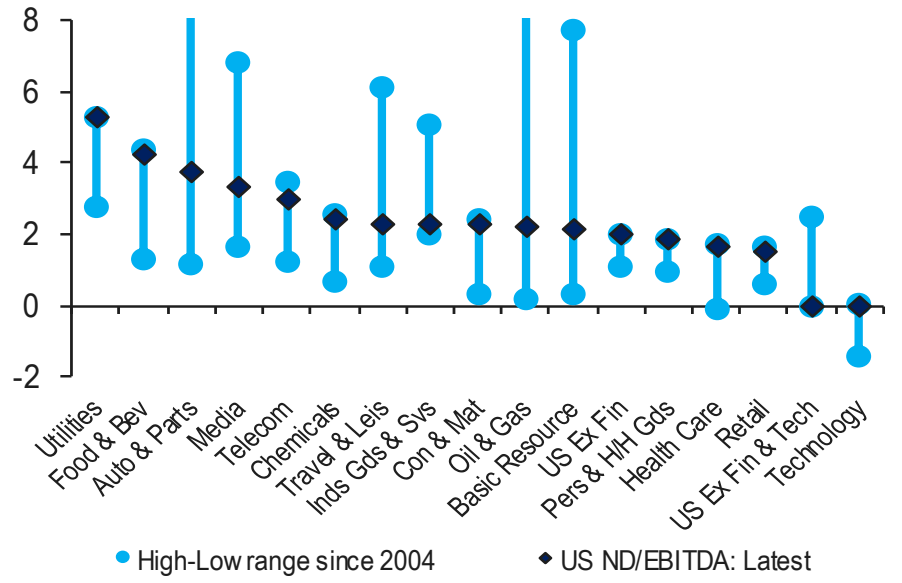
Source: Datastream, Barclays Research

European sectors ND/EBITDA in the historical context



Source: Datastream, Barclays Research

US sectors ND/EBITDA in the historical context

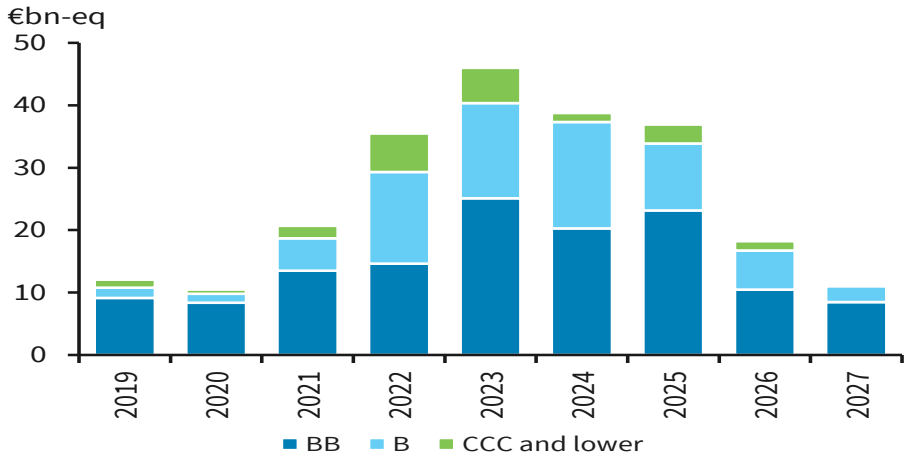


Source: Datastream, Barclays Research

Funding costs remain low

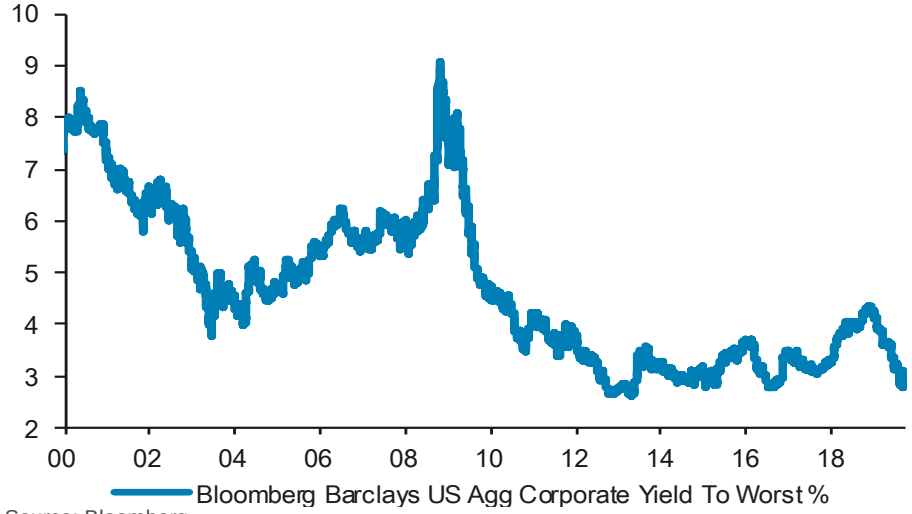
- Rising funding costs will only be felt gradually by the market as a whole, as companies across the credit spectrum have used easy funding conditions in recent years to term out their debt.
- Debt cost remains a tailwind for IG-rated credit. In turn, this also makes the deteriorating fundamentals observed in leveraged loan markets less of an immediate concern.

HY market has few maturities coming due the next two years



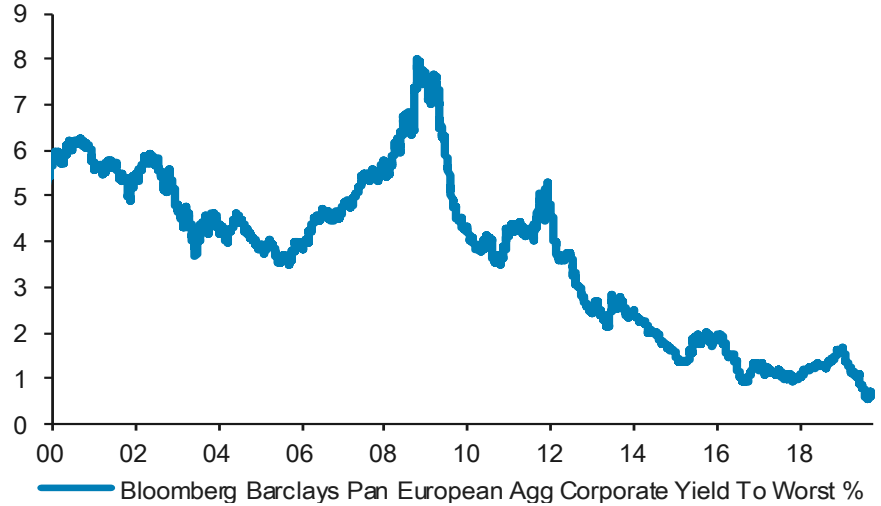
Source: Barclays Credit Research

US corporate credit yields are still low…



Source: Bloomberg

...in Europe too



Source: Bloomberg

Corporate leverage baskets

- Our corporate leverage baskets screen for the SXXP stocks that have very good credit ratings (A3 and above) and those that have poor credit ratings (Baa3 and below) according to Moody's. All stocks in the basket have been filtered for liquidity criterion.

Barclays Europe high credit rating basket (BCEUELDR)

Ticker	Name	Sector	Debt Rating	ND/EBITDA 18e
EQNR NO	Equinor ASA	Energy	Aa2	0.4
RDSA NA	Royal Dutch Shell PLC-A	Energy	Aa2	1.0
FP FP	Total SA	Energy	Aa3	0.7
PROX BB	Proximus	Comm. Svs.	A1	1.1
BMW GY	BMW AG	C Disc	A1	(1.3)
ULVR LN	Unilever PLC	C Staples	A1	2.0
NOVN SE	Novartis AG-Reg	Health Care	A1	0.9
SAN FP	Sanofi	Health Care	A1	1.5
BAS GY	BASF SE	Materials	A1	1.7
SCMN SE	Swisscom AG	Comm. Svs.	A2	1.8
DAI GY	Daimler AG	C Disc	A2	(0.9)
HEN3 GY	Henkel AG	C Staples	A2	0.5
GSK LN	GlaxoSmithKline PLC	Health Care	A2	2.2
AIR FP	Airbus SE	Industrials	A2	(1.6)
ATCOA SS	Atlas Copco AB-A Shs	Industrials	A2	0.2
HO FP	Thales SA	Industrials	A2	(1.6)
SAP GY	Sap SE	IT	A2	0.2
BLT LN	BHP Billiton PLC	Materials	A2	0.4
ENGI FP	Engie	Utilities	A2	2.6
TEL NO	Telenor ASA	Comm. Svs.	A3	0.9
CCL LN	Carnival PLC	C Disc	A3	1.9
CPG LN	Compass Group PLC	C Disc	A3	1.5
ML FP	Michelin (CGDE)	C Disc	A3	0.7
DGE LN	Diageo PLC	C Staples	A3	2.2
OMV AV	OMV AG	Energy	A3	0.5
AZN LN	AstraZeneca PLC	Health Care	A3	2.0
EN FP	Bouygues SA	Industrials	A3	1.3
DPW GY	Deutsche Post AG-Reg	Industrials	A3	1.9
MAN GY	MAN SE	Industrials	A3	2.9
DG FP	Vinci SA	Industrials	A3	2.1
AI FP	Air Liquide SA	Materials	A3	2.5
DSM NA	Koninklijke DSM NV	Materials	A3	0.4
EDF FP	EDF	Utilities	A3	2.5
SEV FP	Suez	Utilities	A3	3.1

Barclays Europe low credit rating basket (BCEUEHDR)

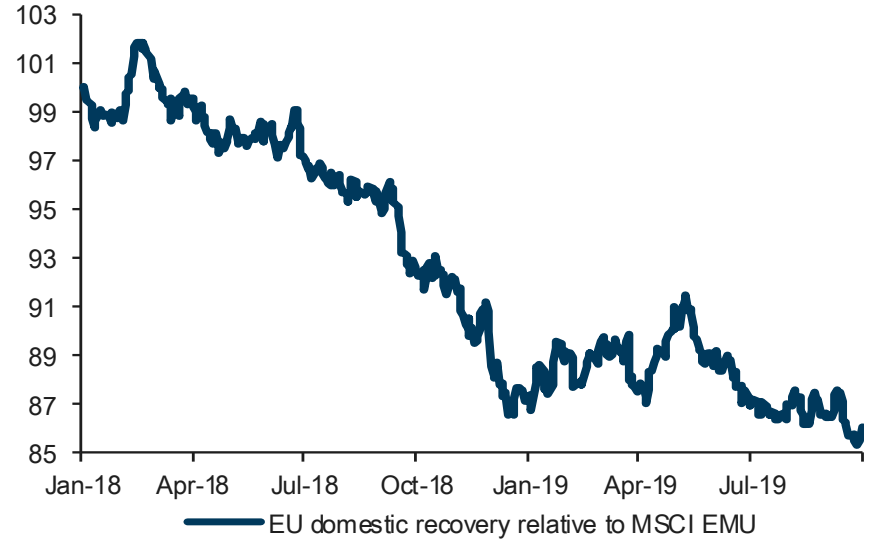
Ticker	Name	Sector	Debt Rating	ND/EBITDA 18e
TIT IM	Telecom Italia SpA	Comm. Svs.	Ba1	3.1
EO FP	Faurecia	C Disc	Ba1	0.1
UG FP	Peugeot SA	IT	Ba1	(1.0)
TSCO LN	Tesco PLC	C Staples	Ba1	0.7
CNHI IM	CNH Industrial NV	Industrials	Ba1	3.6
LDO IM	Leonardo SpA	Industrials	Ba1	1.7
NOKIA FH	Nokia OYJ	IT	Ba1	(1.3)
CLN SE	Clariant AG-Reg	Materials	Ba1	1.4
TUI LN	Tui AG-Di	C Disc	Ba2	0.2
ERICB SS	Ericsson Lm-B Shs	IT	Ba2	(1.1)
TKA GY	thyssenkrupp AG	Materials	Ba2	1.3
FCA IM	Fiat Chrysler	C Disc	Ba3	(0.2)
INF LN	Informa PLC	Comm. Svs.	Baa3	2.9
ITV LN	ITV PLC	Comm. Svs.	Baa3	1.1
KPN NA	Koninklijke KPN NV	Comm. Svs.	Baa3	2.8
TEF SQ	Telefonica SA	Comm. Svs.	Baa3	2.8
RNO FP	Renault SA	C Disc	Baa3	(0.6)
RCO FP	Remy Cointreau	C Staples	Baa3	1.0
FRE GY	Fresenius SE & Co KGaA	Health Care	Baa3	2.4
LHA GY	Deutsche Lufthansa-Reg	Industrials	Baa3	0.7
MTX GY	MTU Aero Engines AG	Industrials	Baa3	1.4
AAL LN	Anglo American PLC	Materials	Baa3	0.3
MT NA	ArcelorMittal	Materials	Baa3	0.8
HEI GY	HeidelbergCement AG	Materials	Baa3	2.8
STERV FH	Stora Enso OYJ	Materials	Baa3	1.1
EDP PL	EDP SA	Utilities	Baa3	4.4
RWE GY	RWE AG	Utilities	Baa3	4.3
ATL IM	Atlantia SpA	Industrials	Baa3*-	5.1

Source: Bloomberg, IBES, Datastream, Moody's, Barclays Research Notes: * Moody's debt rating for senior unsecured debt is considered. . For more information please see our report **2019 Outlook - Late Cycle Blues**, 28 Nov 2018

4. Fiscal easing beneficiaries

- In 2019, the Eurozone looks set to deliver its most accommodative fiscal policy in a decade, driven by Germany, France and Italy. This should help domestic plays (BCEUEUDR).
- Our economists project the fiscal impulse to add 0.12-0.15pp, included in their 1.1% GDP growth forecast for this year, and look for the tailwind to carry on into 2020.
- Combined with a healthy labour market, resilient corporates and favourable financing conditions, loosening fiscal policies should provide a lift to private demand.

Domestic spending plays underperformed massively in 2018 but has been stable ytd



Source: Datastream, Barclays Research

Companies benefitting from fiscal easing (BCEUEUDR)

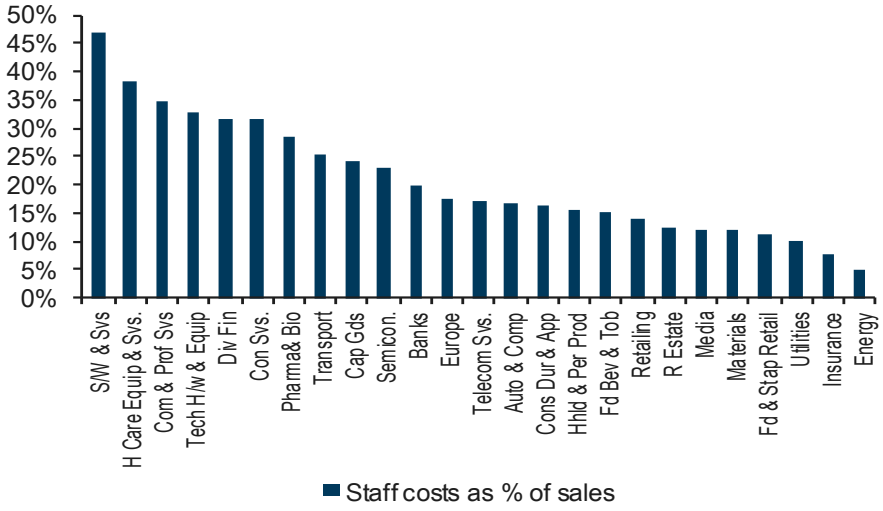
Ticker	Name	Sector	Mcap ($bn)	Europe exposure %
AC FP	Accor	C Disc	12.0	53%
BOSS CY	Boss (Hugo)	C Disc	5.0	63%
DHER CR	Delivery Hero	C Disc	7.6	35%
FNAC FP	FNAC Darty	C Disc	2.1	100%
ITX SM	Inditex	C Disc	92.3	61%
UC FP	Peugeot	C Disc	22.8	78%
RNO FP	Renault	C Disc	20.3	64%
RKET CY	Rocket Internet	C Disc	4.0	67%
SK FP	Seb	C Disc	8.4	52%
TCYM IM	Technogym	C Disc	2.5	60%
TUI1 GR	TUI	C Disc	6.3	100%
ZAL GR	Zalando	C Disc	9.9	100%
BEI CY	Beiersdorf	C Staples	25.3	51%
CA FP	Carrefour	C Staples	15.3	68%
CPR IM	Davide Campari	C Staples	11.2	31%
A3M SQ	Atresmedia Corp	Comm Svs.	1.1	97%
FNTN CY	Freenet	Comm Svs.	2.9	100%
MMB FP	Lagardere Croupe	Comm Svs.	3.5	68%
MMT FP	M6-Metropole Tv	Comm Svs.	2.4	87%
TL5 SQ	Mediaset Espana	Comm Svs.	2.6	97%
PSM CY	Prosiebensat 1 Media	Comm Svs.	4.0	89%
RRTL CY	RTL Croup (Lux)	Comm Svs.	9.2	70%
SAX CY	Stroeer	Comm Svs.	3.3	87%
TFI FP	TF1 (Tv.Fse.1)	Comm Svs.	2.1	96%
VIV FP	Vivendi	Comm Svs.	38.4	85%
ADEN SW	Adecco	Industrials	8.9	54%
ATL IM	Atlantia	Industrials	21.1	86%
EN FP	Bouygues	Industrials	13.5	79%
FGR FP	Eiffage	Industrials	9.6	97%
RAND NA	Randstad	Industrials	9.8	69%
RXL FP	Rexel	Industrials	3.7	55%
RYA ID	Ryanair Holdings	Industrials	15.1	100%
SGO FP	Saint Gobain	Industrials	20.2	56%
SPIE FP	Spie	Industrials	2.9	69%
DG FP	Vinci	Industrials	58.3	80%
DWNI CY	Deutsche Wohnen	Real Estate	17.7	100%
GFC:FP	Gecina Reit	Real Estate	11.4	100%
LI FP	Klepierre REIT	Real Estate	10.7	90%
VNA CY	Vonovia	Real Estate	27.0	100%

Source: Bloomberg, IBES, Datastream, Barclays Research. For more information please see our report **Fiscal easing on its way, but lower-for-longer yields to constrain the broader risk-on trade**, 25 Mar 2019

5. Wage inflation

- Wage inflation is rebounding in Europe as labour markets are tightening. It is most pronounced in the UK and Germany and could be problematic for those companies that are very labour-intensive and have limited pricing power.
- We created a basket of the stocks that have the biggest labour costs share of revenues across the SXXP sectors. All stocks have a market cap of at least c.$10bn.

Labour costs as a share of revenues for European sectors



Source: Datastream, Barclays Research

Companies sensitive to rising wages (BCEUEWIN)

Ticker	Name	Sector	Staff costs as % of sales	Mkt cap ($bn)
SCMN SE	Swisscom 'R'	Comm Services	26%	27.6
PROX BB	Proximus	Comm Services	21%	11.1
PUB FP	Publicis Groupe	Consumer Discretionary	62%	15.7
WPP LN	WPP	Consumer Discretionary	54%	23.0
SW FP	Sodexo	Consumer Discretionary	48%	20.3
IHG LN	Ictl.Htls.Gp.	Consumer Discretionary	36%	12.1
UHR SE	The Swatch Group 'B'	Consumer Discretionary	29%	12.6
LISN SE	Choc.Lindt & Spruengli	Consumer Staples	22%	9.8
OR FP	L'Oreal	Consumer Staples	21%	124.1
AD NA	Koninklijke Ahold Delhaize	Consumer Staples	14%	27.4
ABF LN	Associated Brit.Foods	Consumer Staples	17%	30.2
TSCO LN	Tesco	Consumer Staples	13%	23.2
JMT PL	Jeronimo Martins	Consumer Staples	8%	12.2
HO FP	Thales	Industrials	40%	22.8
FER SQ	Ferrovial	Industrials	38%	16.6
SIE GY	Siemens (Xet)	Industrials	36%	118.5
KNEBV FH	Kone 'B'	Industrials	30%	24.2
SCHP SE	Schindler 'P'	Industrials	41%	9.4
CAP FP	Capgemini	Information Technology	63%	20.0
ERICB SS	Ericsson 'B'	Information Technology	38%	20.2
NZYMB DC	Novozymes	Materials	26%	14.4
GIVN SE	Givaudan 'N'	Materials	23%	21.3
EVK GY	Evonik Industries (Xet)	Materials	23%	17.6
AKZA NA	Akzo Nobel	Materials	19%	22.1
SRG IM	SNAM	Energy	7%	17.2
EDF FP	EDF	Utilities	18%	36.6
ENGI FP	Engie	Utilities	16%	41.9

Source: Worldscope, Datastream, Barclays Research For more information please see our report **2019 Outlook - Late Cycle Blues**, Nov 28,2018

6. Oil price volatility

- Uncertainty about the direction of oil in 2019 is thus elevated, which will have key implications for growth, earnings and inflation. We created two baskets of the European stocks that have the most positive/negative correlation to oil price within each level 1 sector.

Barclays Europe positive sensitivity to oil basket (BCEUEHCO)

Ticker	Name	Sector	Mkt cap ($bn)	Correlation to Oil
EQNR NO	Equinor	Energy	79.6	45%
TEN IM	Tenaris	Energy	16.1	43%
BLT LN	BHP Billiton	Materials	43.2	39%
RDSA NA	Royal Dutch Shell	Energy	139.0	38%
ENI IM	ENI	Energy	60.6	37%
FP FP	Total	Energy	151.1	37%
REP SQ	Repsol Ypf	Energy	28.2	35%
BP/ LN	BP	Energy	136.0	33%
AAL LN	Anglo American	Materials	30.5	33%
MT NA	Arcelormittal	Materials	24.5	28%
ANTO LN	Antofagasta	Materials	10.4	27%
RIO LN	Rio Tinto	Materials	63.2	24%
SAND SS	Sandvik	Industrials	18.5	22%
AHT LN	Ashtead Group	Industrials	10.8	16%
RNO FP	Renault	C DIsc	19.9	15%
ATCOA SS	Atlas Copco A	Industrials	19.7	15%
FCA IM	Fiat Chrysler Autos.	C DIsc	25.0	12%
BMW GY	BMW (Xet)	C DIsc	51.1	12%
PSON LN	Pearson	C DIsc	9.5	12%
SU FP	Schneider Electric	Industrials	41.9	12%
BRBY LN	Burberry Group	C DIsc	9.2	11%
EDF FP	EDF	Utilities	49.7	7%
FORTUM FH	Fortum	Utilities	18.8	5%
TEL2B SS	Tele2 B	Comm. Svs.	7.6	4%
CNA LN	Centrica	Utilities	10.5	0%
DRI GY	1&1 Drillisch	Comm. Svs.	8.8	0%

Barclays Europe negative sensitivity to oil basket (BCEUELCO)

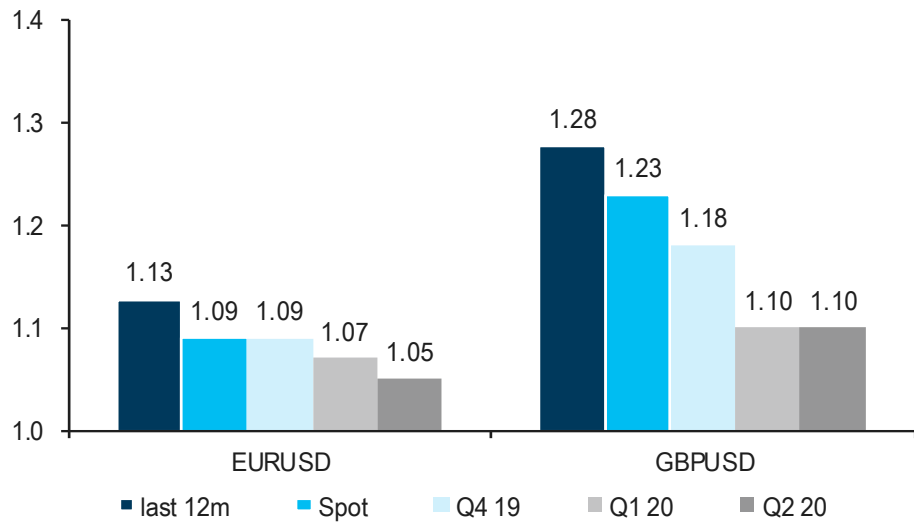
Ticker	Name	Sector	Mkt cap ($bn)	Correlation to Oil
SCMN SE	Swisscom 'R'	Comm. Svs.	24.1	-27%
TRN IM	Terna Rete Elettrica Naz	Utilities	11.0	-26%
BARN SE	Barry Callebaut	C Staples	9.5	-26%
NESN SE	Nestle 'R'	C Staples	258.7	-24%
LISN SE	Lindt & Spruengli	C Staples	10.8	-23%
RYA ID	Ryanair Holdings	Industrials	15.4	-23%
REE SQ	Red Electrica	Utilities	11.7	-22%
NOVN SE	Novartis 'R'	Health Care	226.0	-22%
GIVN SE	Givaudan 'N'	Materials	22.5	-22%
COLR BB	Colruyt	C Staples	9.7	-21%
MAN GY	Man (Xet)	Industrials	14.5	-21%
ADP FP	Adp	Industrials	19.3	-21%
ELE SQ	Endesa	Utilities	23.8	-20%
OR FP	L'Oreal	C Staples	131.8	-20%
DSY FP	Dassault Systemes	IT	30.7	-20%
EMSN SE	EMS-Chemie 'N'	Materials	12.7	-19%
LUX IM	Luxottica	C Disc	28.0	-19%
BEI GY	Beiersdorf (Xet)	C Staples	26.9	-19%
ELISA FH	Elisa	Comm. Svs.	7.2	-19%
PROX BB	Proximus	Comm. Svs.	8.9	-19%
AM FP	Dassault Aviation	Industrials	12.9	-19%
KNIN SE	Kuehne & Nagel Intl.	Industrials	16.0	-18%
SY1 GY	Symrise (Xet)	Materials	10.3	-18%
SW FP	Sodexo	C Disc	15.6	-17%
CPG LN	Compass Group	C Disc	34.3	-16%
ITX SQ	Inditex	C Disc	90.7	-15%
CCL LN	Carnival	C Disc	10.0	-13%
AKZA NA	Akzo Nobel	Materials	20.8	-10%

Source: Bloomberg, IBES, Datastream, Barclays Research. For more information please see our report **2019 Outlook - Late Cycle Blues**, 28 Nov 2018

7. The weak euro is a tailwind for selected Eurozone Exporters

- Our Eurozone exporter basket includes the stocks that derive the biggest share of revenue from abroad and are not overly exposed to EM. It is available on Bloomberg with **BCEUEUEX** ticker.
- A potential further rebound in Euro could hurt the space in the near term, but Barclays forecasts lower EURUSD down the road.

Barclays FX forecasts



Source: Bloomberg, Barclays FX Research

Barclays Eurozone exporters basket (BCEUEUEX)

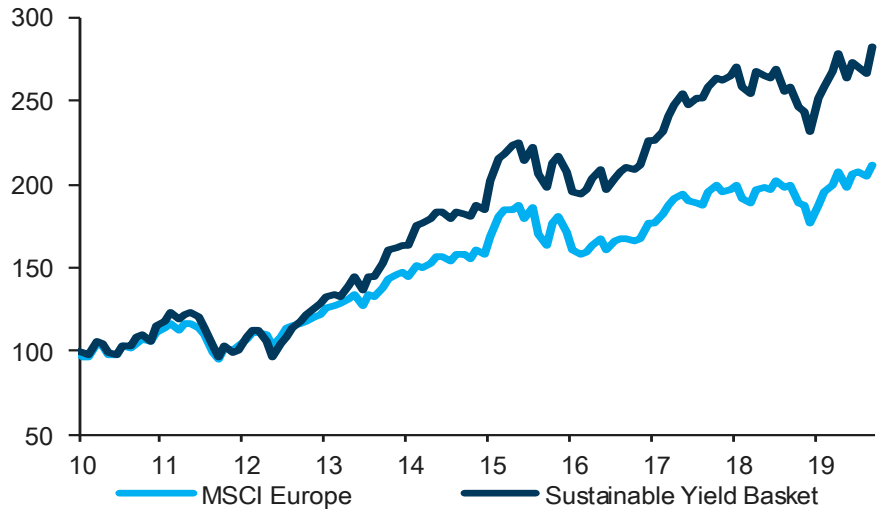
Ticker	Name	Sector	Country	Mcap ($bn)	Non Europe exposure
DAI GY	Daimler	C Disc	Germany	74.1	58%
FCA IM	Fiat Chrysler Autos.	C Disc	Italy	26.2	83%
MC FP	LVMH	C Disc	France	180.5	71%
PUB FP	Publicis Groupe	C Disc	France	14.6	72%
SW FP	Sodexo	C Disc	France	16.2	63%
CPR IM	Davide Campari Milano	C Staples	Italy	10.1	55%
AD NA	Koninklijke Ahold Delhaize	C Staples	Netherlands	31.3	70%
TEN IM	Tenaris	Energy	Italy	21.6	90%
AGN NA	Aegon	Financials	Netherlands	13.3	48%
HNR1 GY	Hannover Ruck.	Financials	Germany	15.7	63%
MUV2 GY	Muenchener Ruck.	Financials	Germany	32.3	59%
BAYN GY	Bayer	Health Care	Germany	104.1	62%
FME GY	Fresenius Med.Care	Health Care	Germany	30.9	84%
GRF SQ	Grifols Ord Cl A	Health Care	Spain	12.6	84%
PHIA NA	Philips Eltn.Koninklijke	Health Care	Netherlands	41.9	79%
UCB BB	UCB	Health Care	Belgium	16.5	69%
ACS SQ	ACS Activ.Constr.Y Serv.	Industrials	Spain	13.7	83%
AIR FP	Airbus	Industrials	France	99.2	75%
BNR GY	Brenntag	Industrials	Germany	9.1	57%
HOT GY	Hochtief	Industrials	Germany	11.6	93%
LR FP	Legrand	Industrials	France	19.6	55%
MTX GY	MTU Aero Engines Hldg.	Industrials	Germany	10.9	84%
REN NA	Relx	Industrials	Netherlands	22.9	77%
WKL NA	Wolters Kluwer	Industrials	Netherlands	17.6	69%
DSY FP	Dassault Systemes	IT	France	39.4	58%
SAP GY	SAP	IT	Germany	147.3	86%
UBI FP	Ubisoft Entm.	IT	France	13.4	64%
AI FP	Air Liquide	Materials	France	55.3	63%
HEI GY	Heidelbergcement	Materials	Germany	16.8	68%
SOLB BB	Solvay	Materials	Belgium	13.7	71%

Source: Bloomberg, IBES, Datastream, Barclays Research. For more information please see our report Hold your nerve, equities still have upside, 30 July 2018.

8. The “search for yield” keeps going

- Barclays expects bond yields to remain lower for longer. The stocks that can deliver high and sustainable dividend yields should remain in demand.
- Our basket consists of stocks with positive earnings growth for the last reported year and the next fiscal year. These stocks are also expected to grow their dividends and have a dividend coverage ratio higher than 1.
- It is available on Bloomberg as **BCEUERIC.**

Barclays European sustainable yield basket performance



Barclays European sustainable yield basket (BCEUERIC)

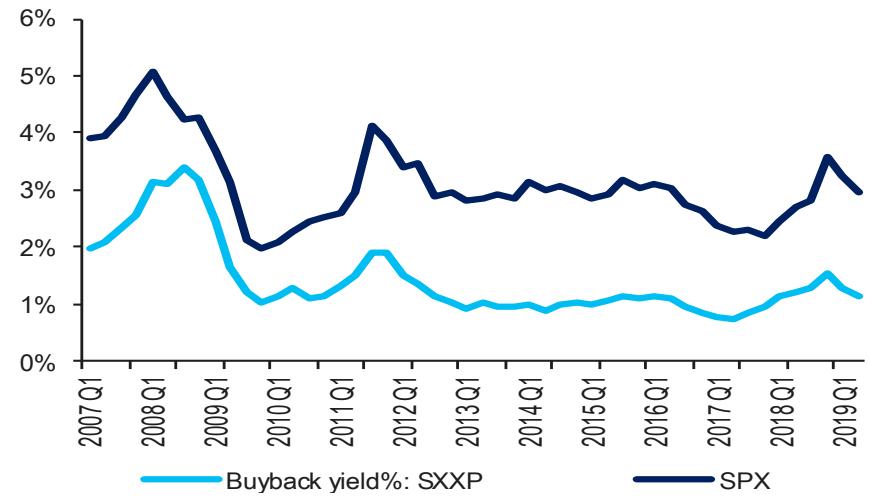
Ticker	Name	Sector	Country	Mcap ($bn)	DY 19e
ITX SQ	Inditex	C Disc	Spain	93.9	3.8%
UG FP	Peugeot	C Disc	France	22.3	4.4%
NXT LN	Next	C Disc	UK	9.4	3.0%
AD NA	Koninklijke Ahold Delhaize	C Staples	Netherlands	26.7	3.9%
BATS LN	British American Tobacco	C Staples	UK	80.3	7.6%
TSCO LN	Tesco	C Staples	UK	28.3	3.6%
FP FP	Total	Energy	France	149.6	5.3%
ENI IM	Eni	Energy	Italy	60.4	5.9%
NESTE FH	Neste	Energy	Finland	26.1	3.0%
G IM	Assicurazioni Generali	Financials	Italy	29.6	5.9%
ALV GY	Allianz	Financials	Germany	101.9	4.5%
AV/ LN	Aviva	Financials	UK	20.8	7.7%
CSGN SE	Credit Suisse Group	Financials	Switzerland	30.7	2.4%
AMUN FP	Amundi (Wi)	Financials	France	14.1	5.0%
VNA GY	Vonovia	Real Estate	Germany	25.9	3.8%
LI FP	Klepierre Reit	Real Estate	France	10.3	7.4%
DG FP	Vinci	Industrials	France	61.6	3.2%
ACS SQ	Acs Activ.Constr.Y Serv.	Industrials	Spain	12.6	5.3%
VOLVB SS	Volvo B	Industrials	Sweden	26.2	3.6%
SU FP	Schneider Electric	Industrials	France	52.6	3.1%
HEXAB SS	Hexagon B	IT	Sweden	19.3	1.3%
RIO LN	Rio Tinto	Materials	UK	78.3	6.2%
HEI GY	Heidelbergcement	Materials	Germany	16.0	3.3%
YAR NO	Yara International	Materials	Norway	13.3	2.4%
ROG SE	Roche Holding	Health Care	Switzerland	197.9	3.3%
NOVOB DC	Novo Nordisk 'B'	Health Care	Denmark	95.1	2.5%
REE SQ	Red Electrica	Utilities	Spain	11.3	5.7%
ENEL IM	Enel	Utilities	Italy	71.1	5.3%
PUB FP	Publicis Groupe	Comm Services	France	12.5	4.8%
DTE GY	Deutsche Telekom	Comm Services	Germany	82.6	5.0%

Source: Bloomberg, IBES, Datastream, Barclays Research.
For more information please see our report Hold your nerve, equities still have upside, 30 July 2018.

Buyback yield inched higher ytd in US and Europe

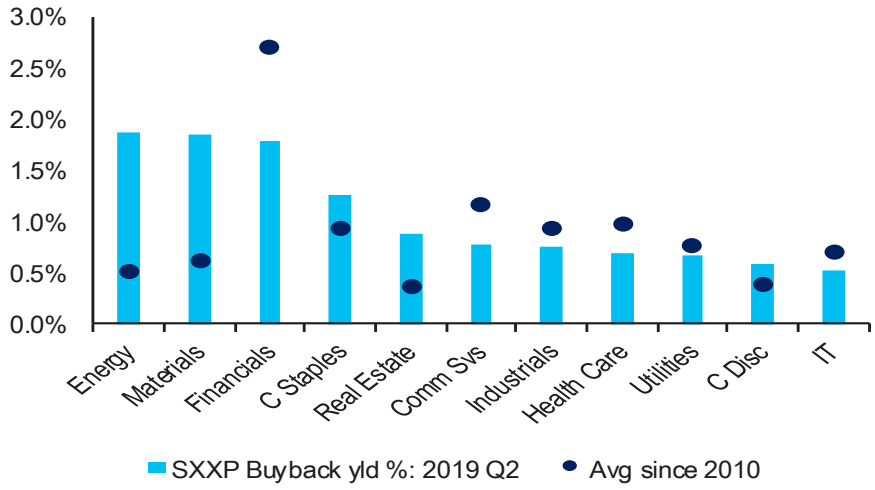
- Buyback yield inched higher ytd across US and Europe.
- Most sectors in US have higher or close-to-average buyback yield.
- In Europe, Materials, Energy and Staples buyback yields were much higher than average recently.

European buyback yield is much lower than for the US



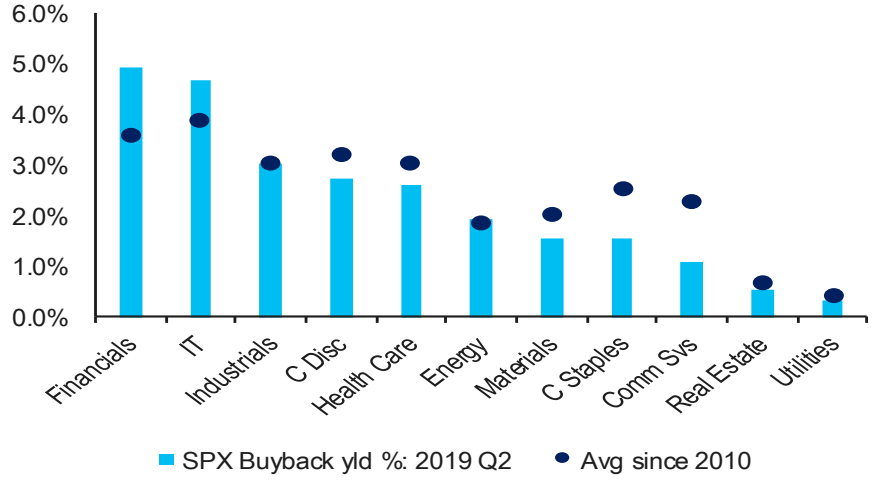
Source: Bloomberg, Barclays Research

In Europe, Materials, Energy and Staples buyback yields were much higher than average recently



Source: Bloomberg, Barclays Research

IT and Financials sectors in US lead the way



Source: Bloomberg, Barclays Research

Equity dividend yield is attractive

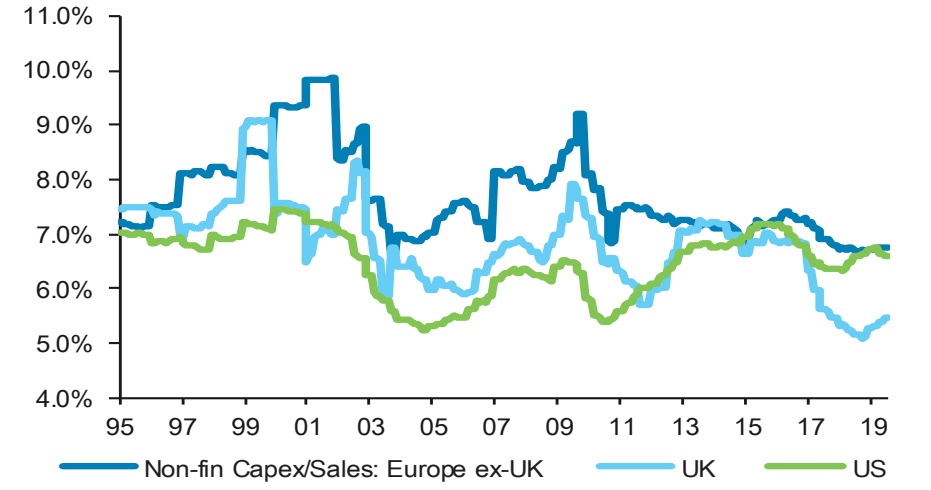
- Against the backdrop of low government bond yields, stocks and sectors that offer high and sustainable yield will be rewarded, in our view.

European Level 2 sector 2019e Dividend yield

Source: Datastream

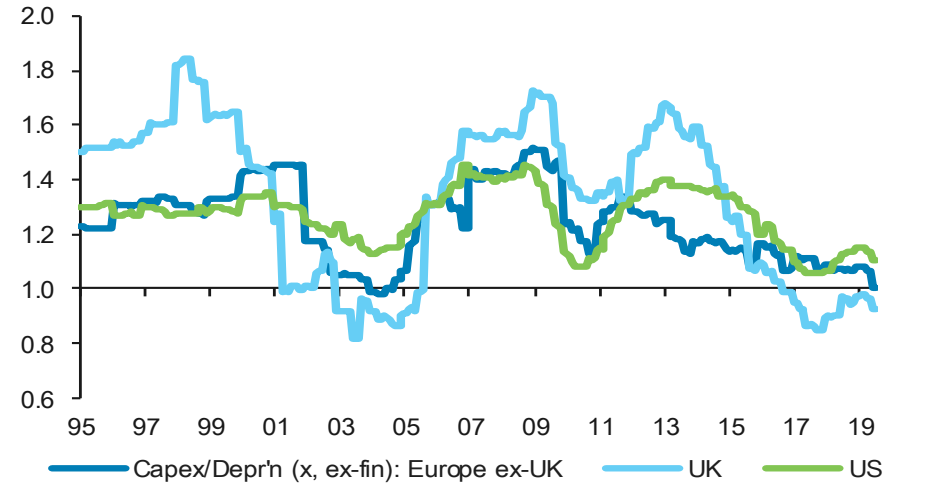
9. Capex discipline - European companies have behaved cautiously this cycle

Capex/Sales is elevated in the US, but depressed in Europe



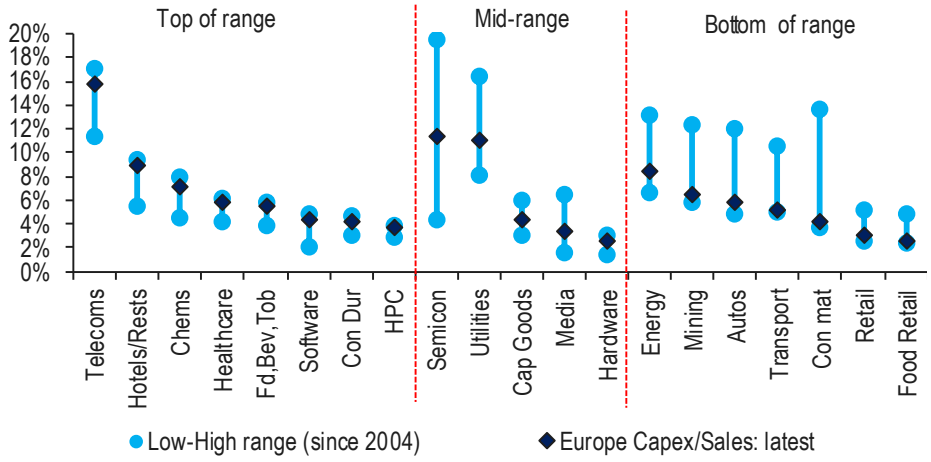
Source: Datastream, Worldscope

Capex/Depreciation suggests less growth capex, and a greater proportion made up by maintenance capex



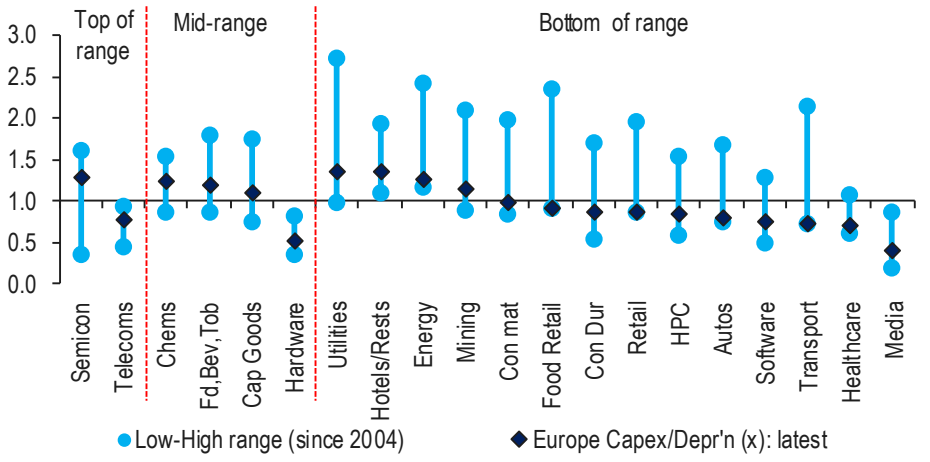
Source: Datastream, Worldscope

Europe sector capex/sales



Source: Datastream, Worldscope

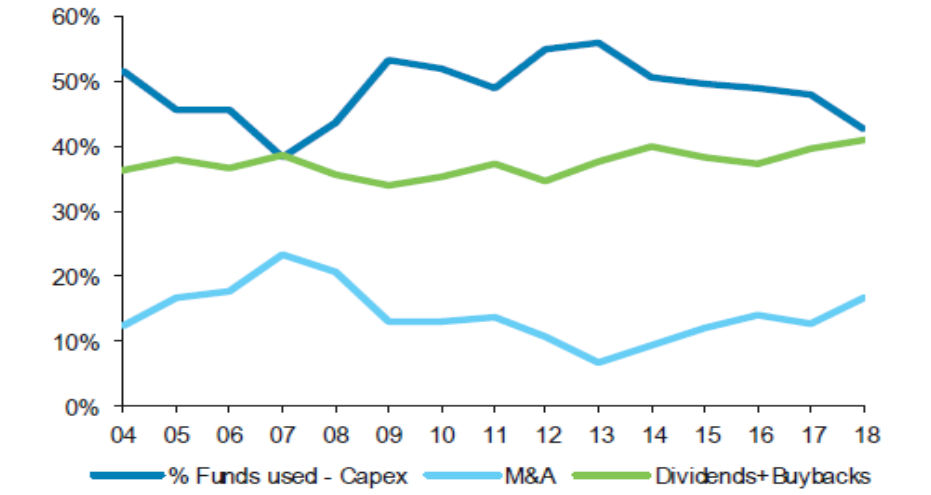
Europe sector capex/depreciation



Source: Datastream, Worldscope

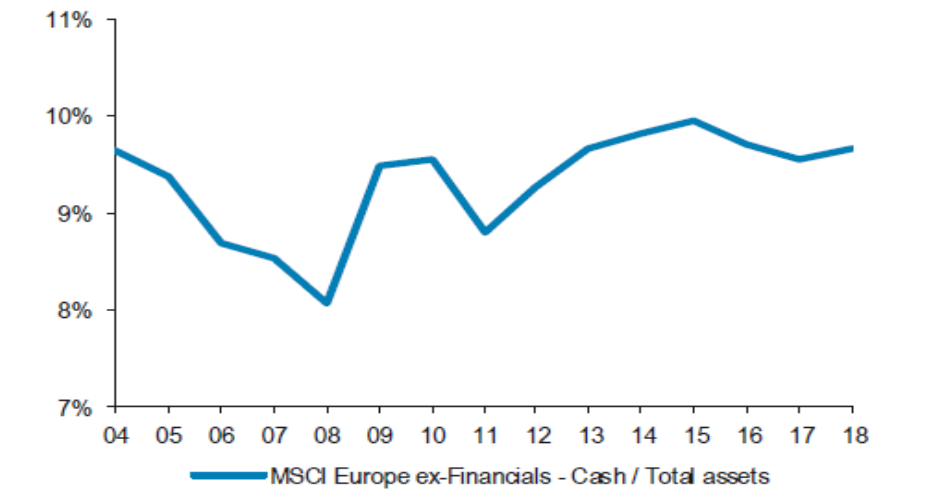
Investors reward cash return over spending

European companies have shifted their use of funds from capex to dividends…



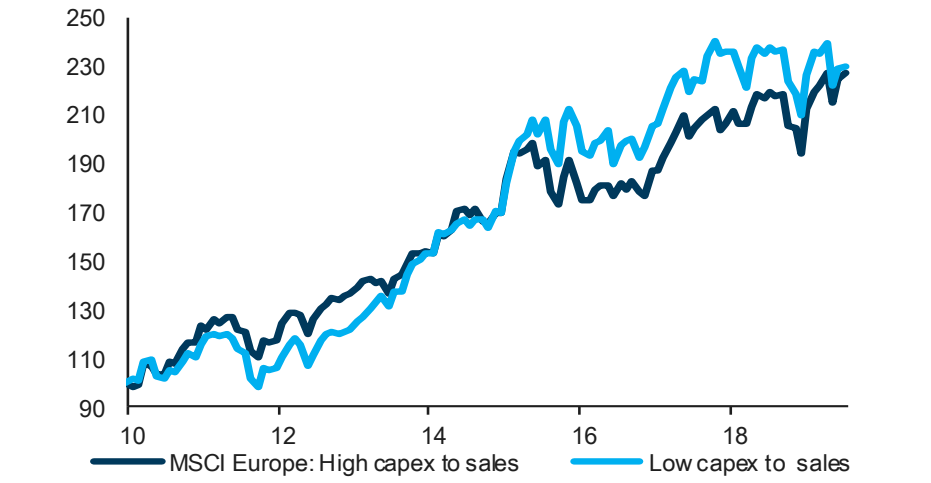
Source: Barclays Research, Worldscope

…and are holding more cash on their balance sheets this cycle compared to the previous one



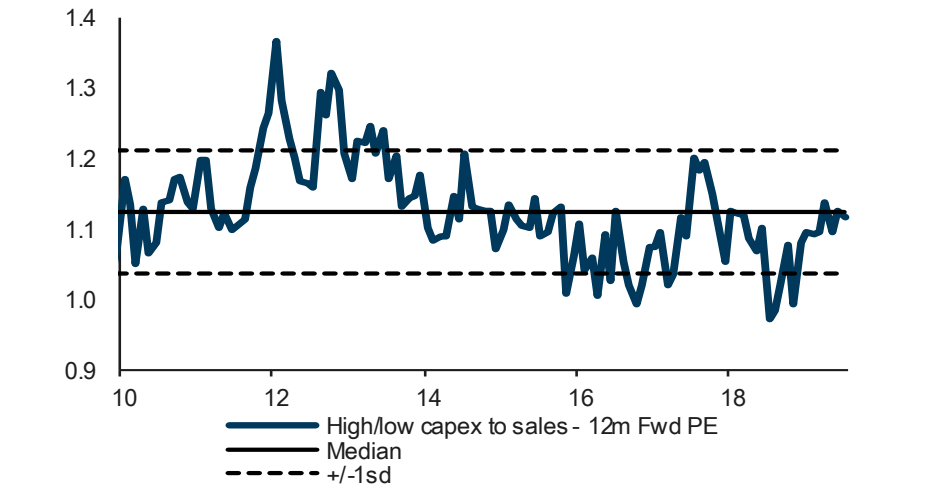
Source: Barclays Research, Worldscope

Low capex spenders have outperformed high spenders in the last five years but lagged recently



Source: Barclays Research, MSCI. Note: sector-neutral, ex-Financials considered.

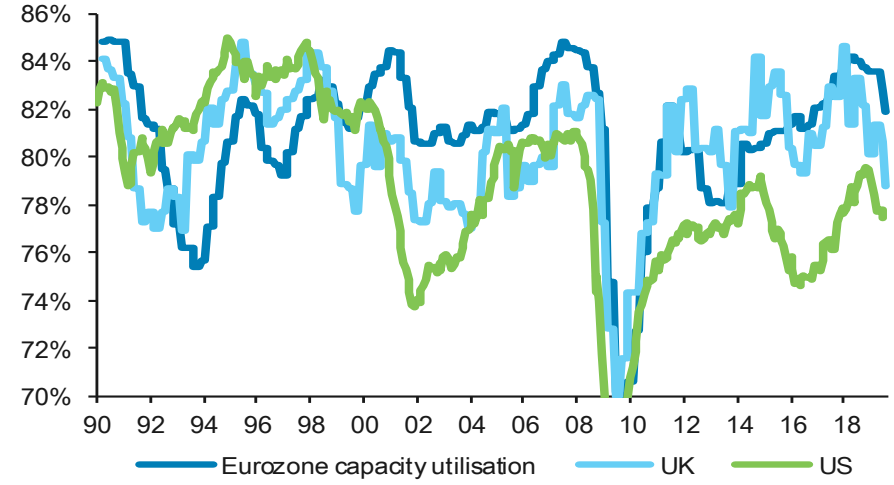
High capex spenders have re-rated recently



Source: Datastream, IBES, Barclays Research.

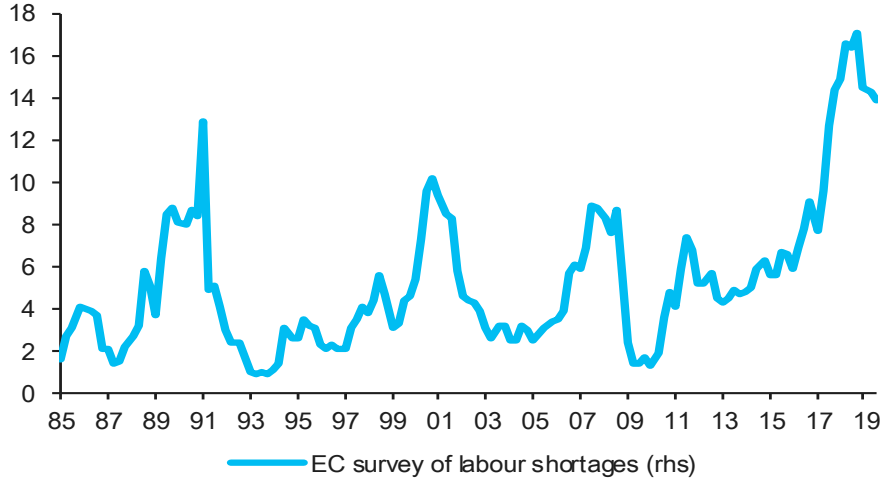
High utilisation rates, labour shortages and low productivity could lead to capital deepening

Capacity utilisation is at cycle-highs, which could lead companies to invest and add capacity



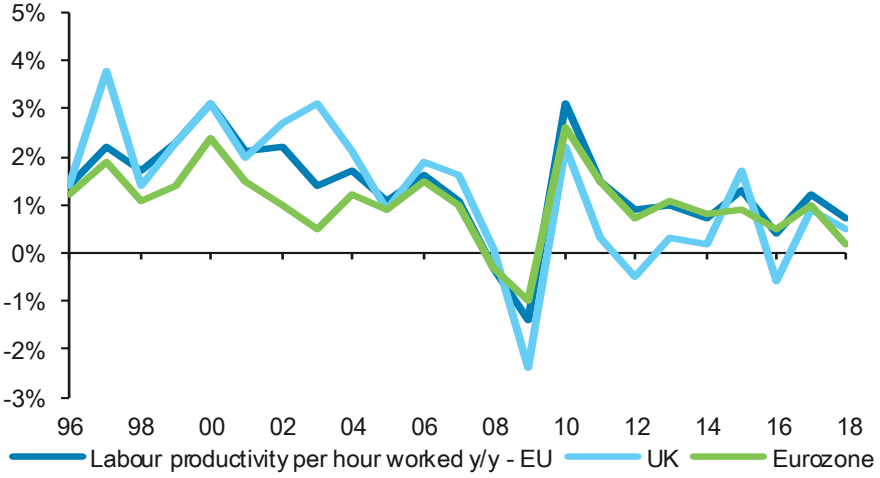
Source: Bloomberg

Labour shortages are elevated



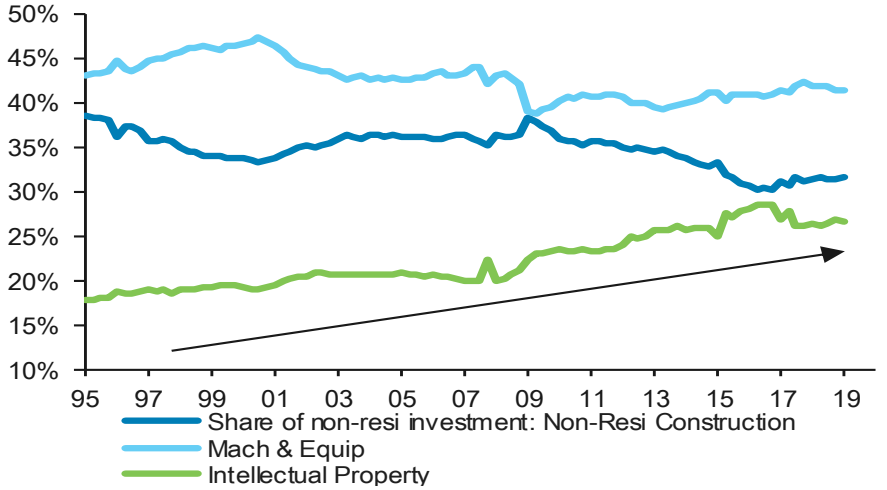
Source: Bloomberg

Productivity growth is on a steady downtrend



Source: Eurostat

Higher investment in Technology versus PP&E



Source: Eurostat, Datastream, Barclays Research.

Capex themes

Stock names related to each Capex theme

Theme	Sector	Company Names
Automation	Industrials	Atlas Copco, ABB*, Siemens*, Schneider Electric*
	Technology	Infineon, STMicro
	Materials	Johnson Matthey
Technology/IT Infrastructure	Technology	ASML, SAP, Temenos, AVEVA, Dassault, Atos, Capgemini, Nokia, Ericsson
E-Commerce	Cons. Disc	ASOS, Boohoo, Zalando, Zooplus
	Technology	Adyen, Wirecard
	Industrials	Deutsche Post, BPost, DSV
Autos: CASE	Industrials	Atlas Copco, ABB*
	Technology	Infineon, STMicro
Renewables & grid integration	Industrials	Vestas*, Siemens-Gamesa*, ABB*, Alstom-GE*, Siemens*, Schneider Electric*, Prysmian*, Nexans*
	Utilities	RWE, Iberdrola, Enel, , National Grid, E.ON
	Technology	Infineon, STMicro
Commodity Capex	Industrials	Sandvik, Metso, Epiroc, Weir
	Oil Services	Tenaris, Subsea 7

Source: Barclays Research, *means the company is not covered by Barclays Research sector analysts but still has exposure to the theme

Sector Allocation

- **OW** Healthcare, Utilities, Real Estate, Insurance, Energy, Construction Materials.
- **MW** Autos, Telecoms, Banks, Mining, Luxury Goods.
- **UW** Industrials, Chemicals, Tech, Staples.

- Our methodology for sector allocation uses both quantitative and fundamental analysis

1) We have developed a European level 2 sector scorecard based on seven variables: Price momentum, P/Book and P/E relative to their historical median, Dividend Yield, EPS growth, EPS revisions and ROE.

2) We then apply a macro overlay to this quant analysis, for example how activity momentum, the direction of bond yields or FX would impact sector preferences

3) We take into account our sector analysts' views on sectors and stocks.

	Barclays Equity Strategy Recommendation	MSCI Europe Weight	Barclays Allocation	Barclays vs Benchmark
Energy	OW	7.3%	9.0%	1.7%
Materials	MW	7.2%	7.0%	-0.2%
Industrials	UW	13.4%	11.0%	-2.4%
Discretionary	MW	9.5%	9.5%	0.0%
Staples	UW	15.1%	14.0%	-1.1%
Healthcare	OW	13.5%	15.0%	1.5%
Financials	MW	17.6%	18.0%	0.4%
IT	UW	5.9%	3.0%	-2.9%
Telecoms	MW	4.7%	4.5%	-0.2%
Utilities	OW	4.4%	6.0%	1.6%
Real Estate	OW	1.4%	3.0%	1.6%
		100.0%	**100.0%**	**0.0%**

Source: Barclays Research, MSCI. Notes: Overweight (OW): The performance of the MSCI Europe sector is expected to outperform the MSCI Europe index in the next 3-6 months. Marketweight (MW): The performance of the MSCI Europe sector is expected to perform in line with the MSCI Europe index in the next 3-6 months. Underweight (UW): The performance of the MSCI Europe sector is expected to underperform the MSCI Europe index in the next 3-6 months

Sector scorecard

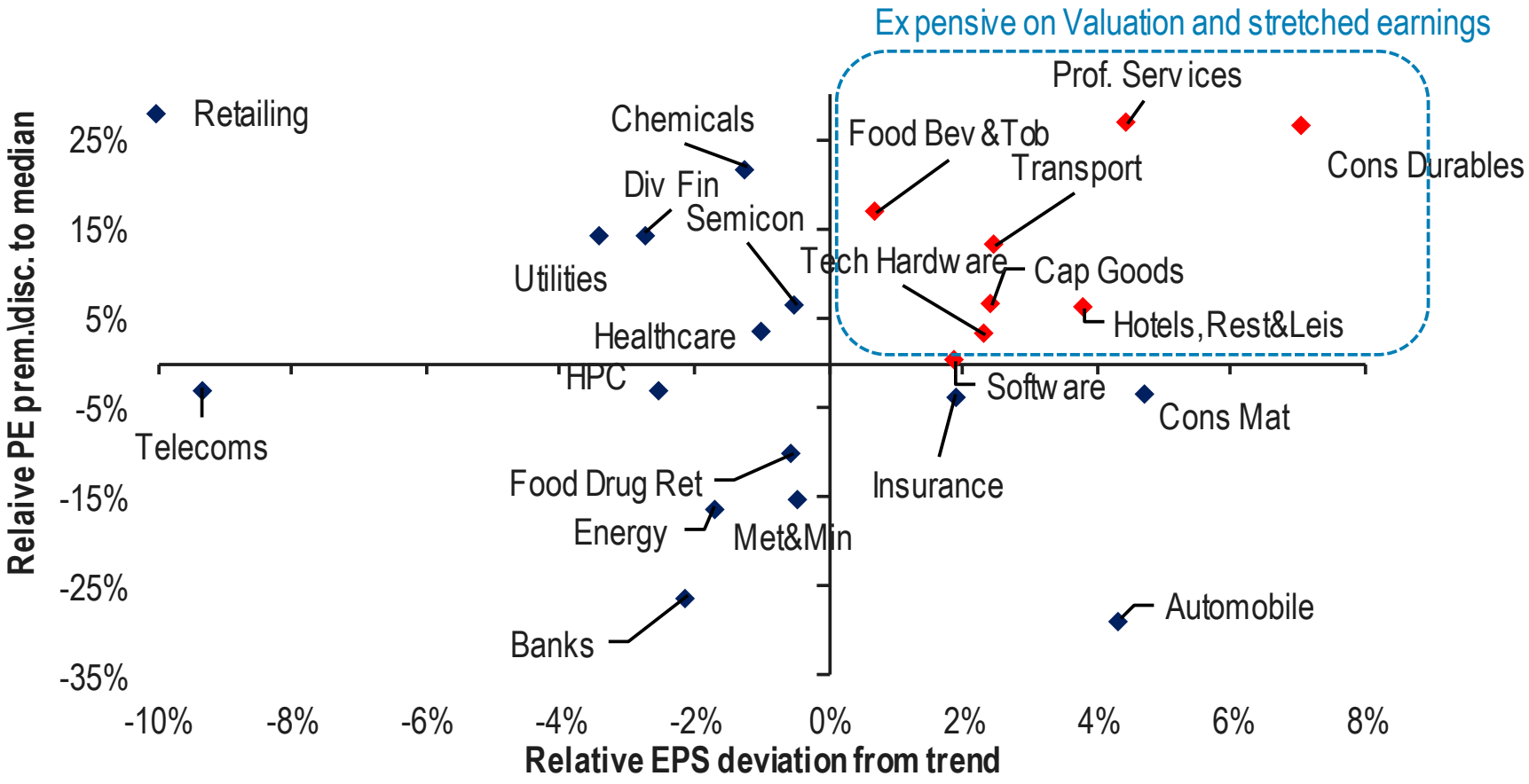
MSCI Europe Sector Scorecard

	Overall rank	Price momentum (1,3 & 6 months)	P/Book vs 10Y median	Fwd P/E vs 10Y median	Fwd Div Yield	EPS y/y ('19e & '20e)	EPS Revisions (current, 1 & 3 months)	ROE
Food Bev&Tob	1	2.3%	-3.9%	5.2%	2.7%	8.9%	19.5%	15.7%
Cons Mat	2	4.5%	-2.3%	-13.2%	3.2%	14.7%	-10.0%	7.5%
Insurance	3	4.8%	12.2%	2.2%	5.0%	9.0%	3.2%	11.0%
Media	4	1.3%	-21.1%	1.5%	3.6%	4.8%	-2.3%	12.6%
Healthcare	5	3.3%	8.3%	5.2%	3.0%	6.8%	5.3%	19.6%
Tech Hardware	6	0.4%	26.7%	-2.5%	2.3%	34.7%	4.0%	14.6%
Real Estate	7	4.1%	-11.2%	-11.1%	4.7%	3.0%	2.5%	5.8%
Automobile	8	2.1%	-26.5%	-13.3%	4.4%	5.3%	-54.3%	11.2%
Energy	9	0.1%	-10.4%	-1.5%	5.9%	8.6%	-71.8%	10.8%
Hotels,Rest&Leis	9	5.0%	-10.6%	1.1%	2.7%	7.5%	-31.0%	16.0%
Met&Min	11	-5.5%	-8.4%	-12.5%	5.2%	-2.4%	-58.3%	14.2%
Banks	12	3.0%	-24.0%	-17.5%	6.4%	0.6%	-68.3%	7.6%
Cap Goods	13	3.4%	11.6%	5.9%	2.8%	8.4%	-9.8%	15.5%
Transport	14	2.1%	15.6%	11.0%	3.0%	15.4%	-20.0%	12.2%
Cons Durables	15	2.6%	11.3%	18.0%	2.1%	9.0%	-12.2%	17.1%
HPC	15	1.0%	36.8%	7.2%	2.4%	6.4%	11.4%	23.8%
Telecoms	17	3.2%	3.6%	2.5%	4.6%	6.0%	-22.0%	9.7%
Food Drug Ret	18	5.9%	-18.8%	5.0%	3.0%	8.8%	-46.0%	9.4%
Prof. Services	19	4.0%	52.2%	20.6%	2.4%	8.9%	-12.0%	32.1%
Retailing	20	1.9%	1.2%	24.3%	4.2%	5.6%	-28.9%	14.8%
Utilities	21	6.4%	23.0%	12.0%	4.5%	8.4%	-25.1%	11.3%
Software	22	-3.1%	10.2%	23.5%	1.5%	9.8%	-12.7%	13.7%
Semicon	22	15.8%	21.1%	4.5%	1.1%	14.0%	-45.0%	14.2%
Div Fin	24	6.4%	-2.0%	17.4%	3.2%	8.6%	-27.3%	5.2%
Chemicals	25	2.7%	-4.7%	19.7%	2.8%	1.8%	-44.3%	10.1%

Source: Barclays Research, MSCI, Refinitiv

Valuation vs. EPS momentum

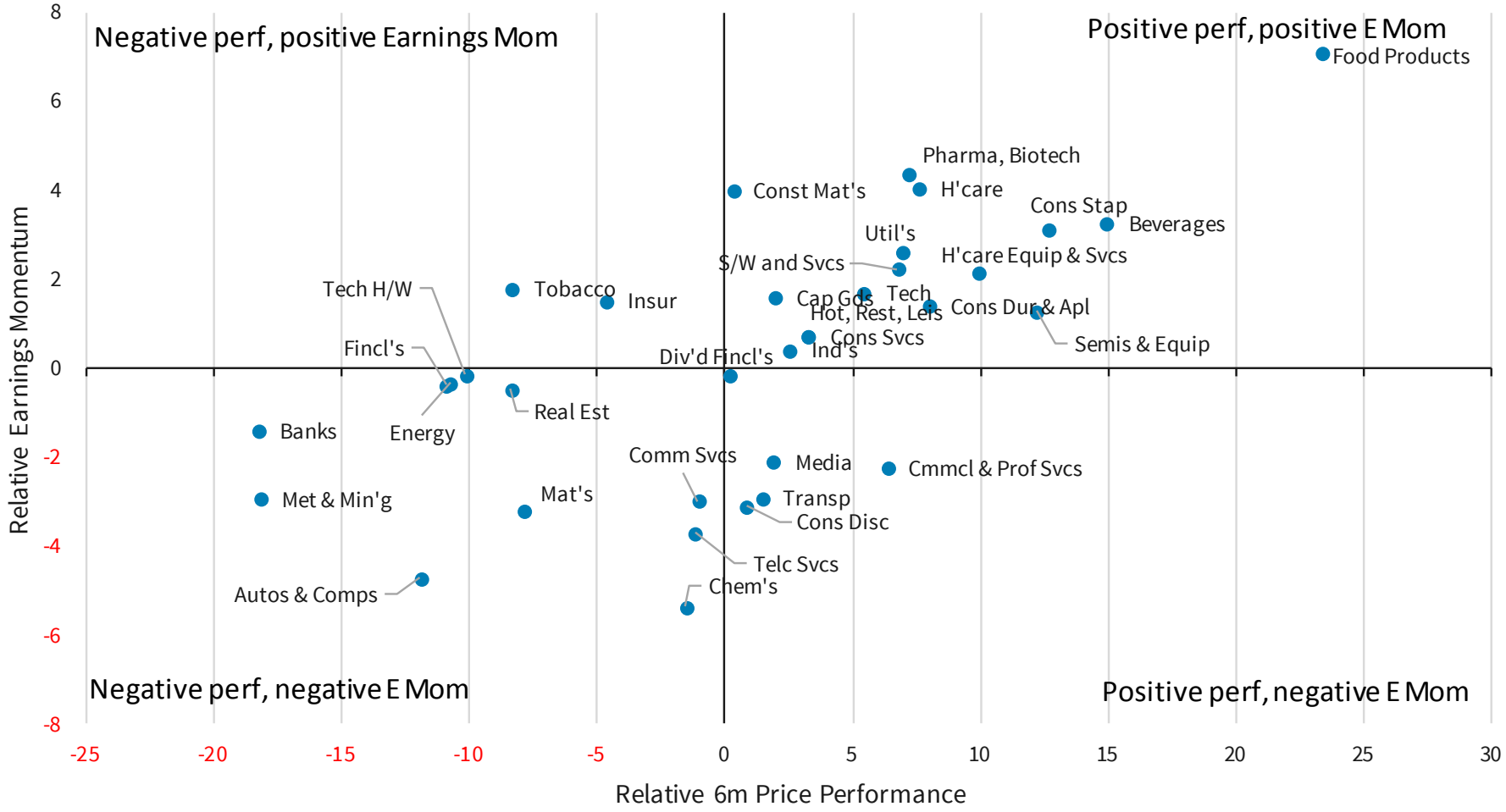
European level 2 sectors EPS deviation from trend compared to relative P/E discount/premium to median



Source: MSCI, IBES, Refinitiv, Barclays Research

Price momentum vs. EPS momentum

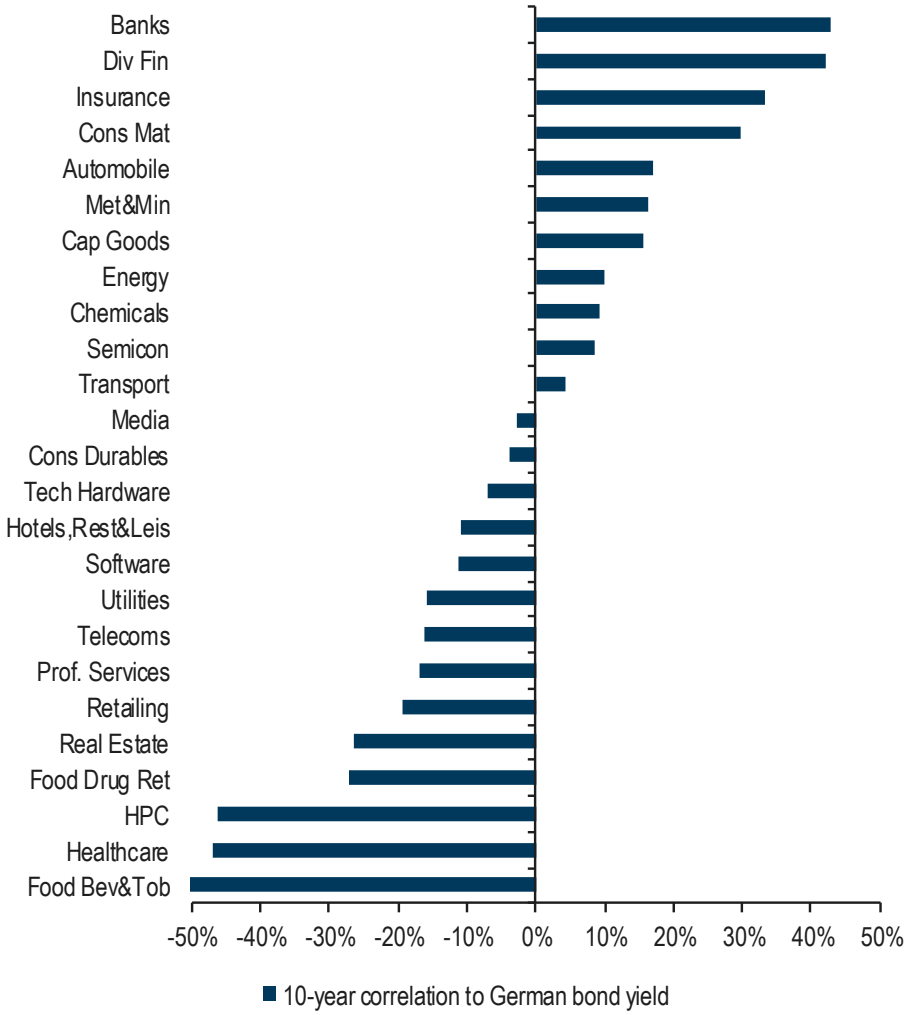
European level 2 sectors relative EPS and Price momentum



Source: MSCI, IBES, Refinitiv, Barclays Research

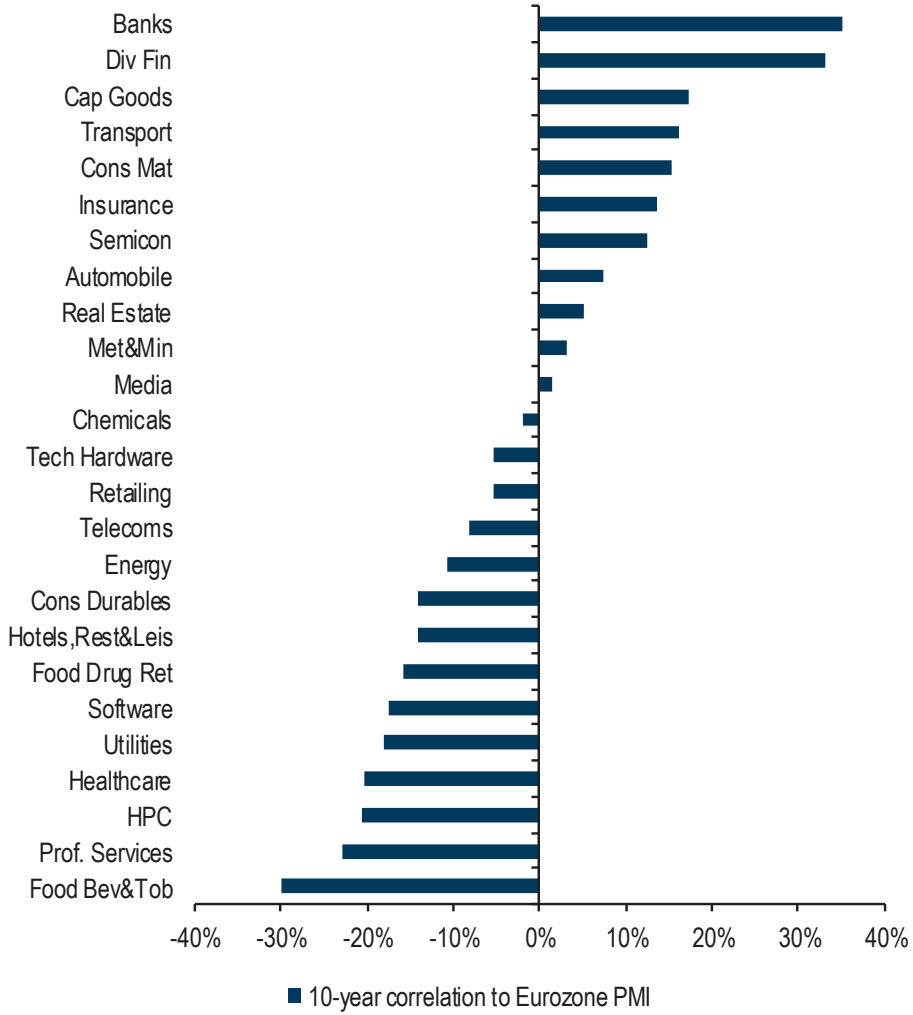
PMI and bond yields' direction matter for sectoral and style leadership

European sectors' correlation to bond yields



Source: Barclays Research, Datastream

European sectors' correlation to PMI



Source: Barclays Research, Datastream

Cyclicals typically outperformed in the late stages of the cycle…

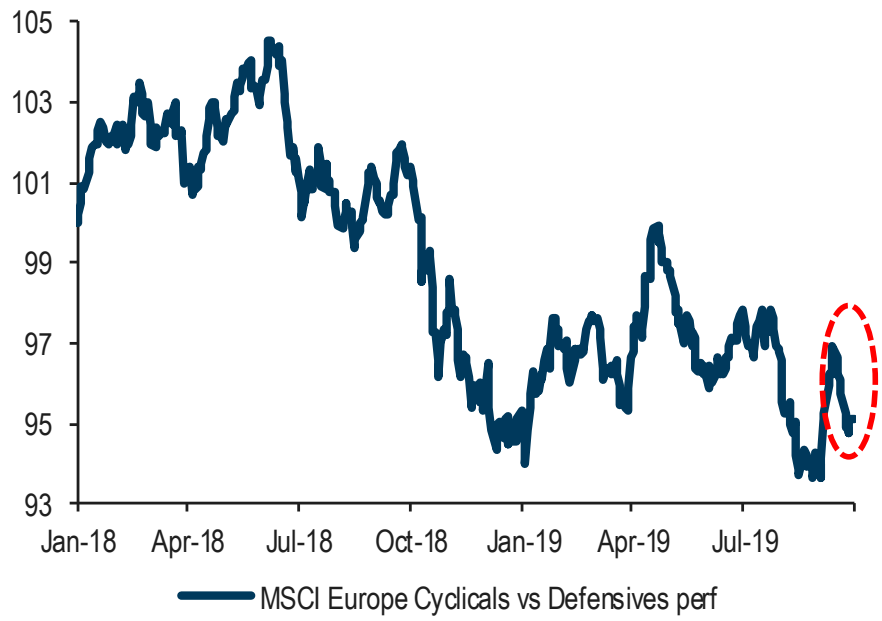
- Cyclicals typically outperform Defensives during the late stage of the cycle.
- Looking at the sectoral performance following past inversions of the US yield curve until the peaks of the S&P500, we found that Cyclicals delivered higher returns than Defensives.
- Materials and Industrials, along with Energy, performed particularly well, while Telecoms and Utilities were the weakest

Cyclicals typically perform during the late stage of the cycle, but not during recessions

Median performance	From Yield Curve inversion to SPX peak 'late cycle'	SPX peak to trough 'recession'
US Market	9.6%	-33.6%
Financials	7.7%	-29.2%
Oil & Gas	31.2%	-32.5%
Materials	13.0%	-27.5%
Industrials	15.4%	-38.6%
C Svs	4.6%	-31.2%
Tech	5.2%	-38.0%
C Gds	0.1%	-30.8%
Healthcare	5.6%	-14.1%
Telecom	-2.5%	-17.8%
Utilities	7.1%	-28.0%
Cyclicals	3.8%	-20.8%
Defensives	0.9%	-11.3%
Cyclicals vs Defensives	4.6%	-10.9%

Source: Datastream

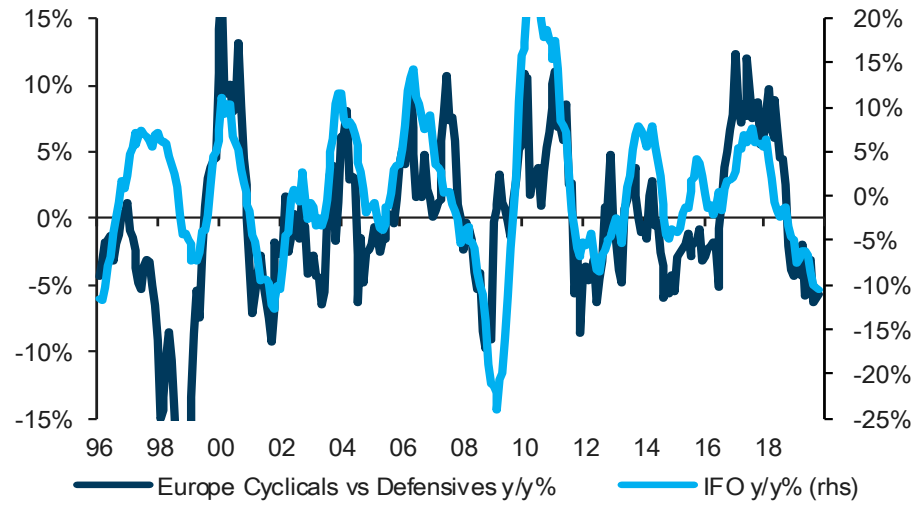
Cyclicals/Defensives have recovered recently



Source: Datastream

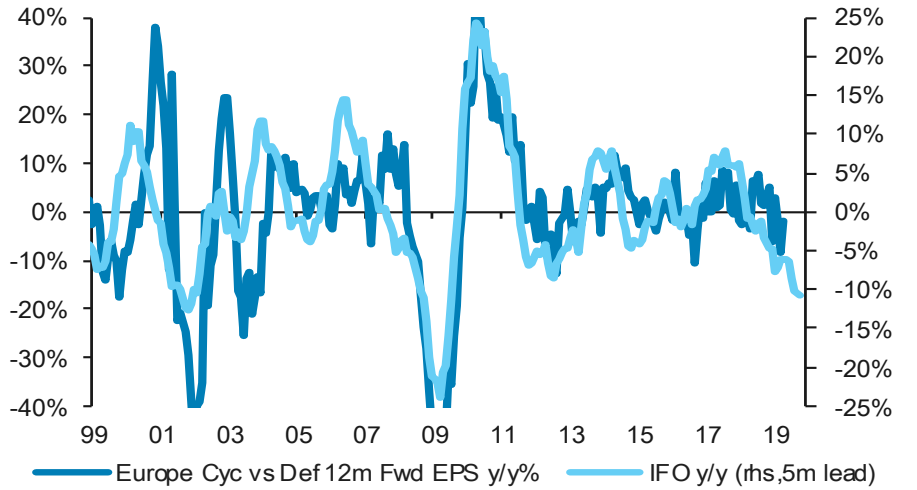
…but their valuations are not depressed and earnings are still at risk

European Cyclicals have declined in line with the falling IFO



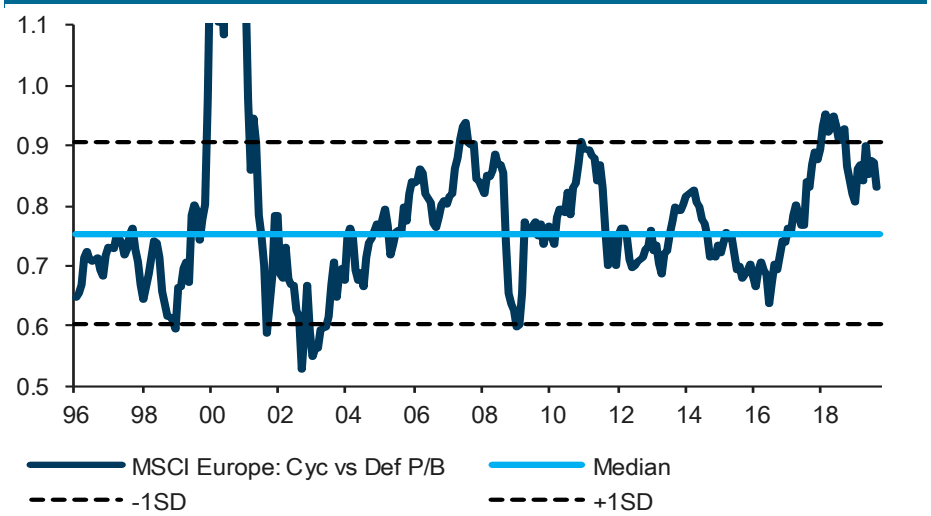
Source: IBES, Datastream

Cyclicals relative EPS momentum has more downside though



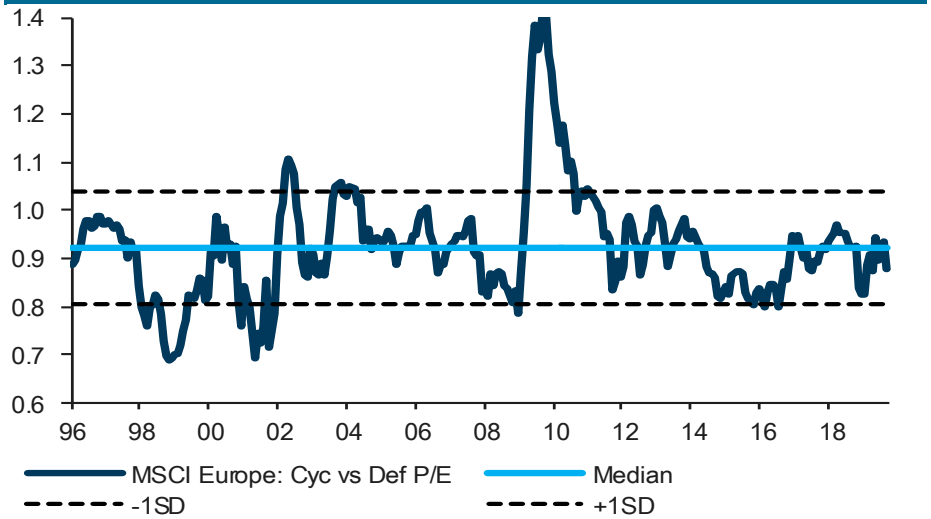
Source: IBES, Datastream

Cyclicals/Defensives P/Book is still expensive



Source: Datastream

Cyclicals/Defensives Fwd P/E is not depressed



Source: Datastream

Cyclicals and Defensives baskets

Barclays European Cyclicals basket (BCEUECYC)

Ticker	Name	Sector	Mkt. cap ($mn)
AIR FP	Airbus	Industrials	101,825
SIE GY	Siemens (Xet)	Industrials	100,487
DG FP	Vinci	Industrials	57,291
SAF FP	Safran	Industrials	56,231
SU FP	Schneider Electric	Industrials	46,340
REL LN	Relx	Industrials	44,016
ABB SS	Abb Ltd N	Industrials	40,916
DPW GY	Deutsche Post (Xet)	Industrials	40,030
AENA SQ	Aena Sme	Industrials	27,809
EXPN LN	Experian	Industrials	25,770
KNEBV FH	Kone 'B'	Industrials	24,361
ATCOA SS	Atlas Copco A	Industrials	24,127
HO FP	Thales	Industrials	24,085
RR/ LN	Rolls-Royce Holdings	Industrials	22,659
ASSAB SS	Assa Abloy B	Industrials	21,656
ATL IM	Atlantia	Industrials	21,457
SAND SS	Sandvik	Industrials	21,111
MC FP	Lvmh	C Disc	188,223
ITX SM	Inditex	C Disc	88,018
RMS FP	Hermes Intl.	C Disc	72,051
DAI GY	Daimler (Xet)	C Disc	66,854
ADS GY	Adidas (Xet)	C Disc	56,229
EL FP	Essilorluxottica	C Disc	51,901
ML FP	Michelin	C Disc	21,690
RIO LN	Rio Tinto	Materials	71,856
BAS GY	Basf (Xet)	Materials	67,575
AI FP	Air Liquide	Materials	54,556
GLEN LN	Glencore	Materials	50,386
BHP LN	Bhp Group	Materials	47,673
AAL LN	Anglo American	Materials	34,733
LHN SW	Lafargeholcim	Materials	30,091
CRH ID	Crh (Dub)	Materials	25,942
SAP GY	Sap (Xet)	IT	151,855
ASML NA	Asml Holding	IT	83,197
NXPI US	Nxp Semiconductors	IT	32,979

Barclays European Defensives basket (BCEUEDEF)

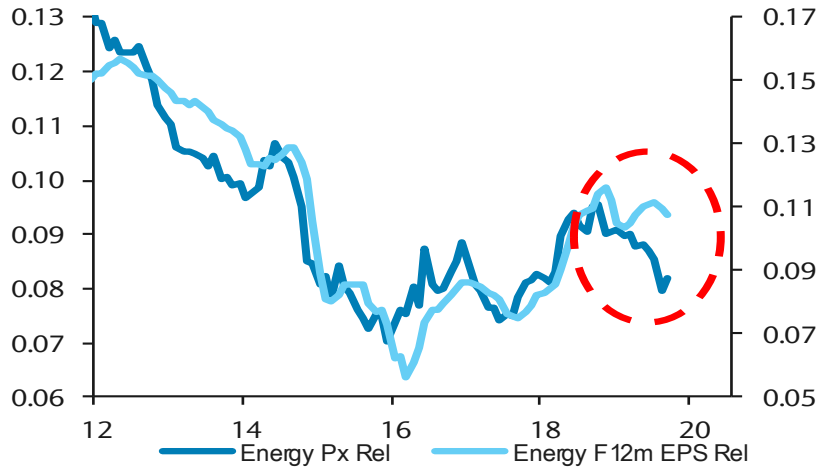
Ticker	Name	Sector	Mkt. cap ($mn)
NESN SW	Nestle 'R'	C Staples	292,881
OR FP	L'Oreal	C Staples	148,687
ABI BB	Anheuser-Busch Inbev	C Staples	141,062
BATS LN	British American Tobacco	C Staples	86,175
BEI GY	Beiersdorf (Xet)	C Staples	27,811
IMB LN	Imperial Brands	C Staples	27,747
ABF LN	Associated Brit.Foods	C Staples	25,810
KYGA LN	Kerry Group 'A'	C Staples	20,030
CARLB DC	Carlsberg B	C Staples	15,649
CA FP	Carrefour	C Staples	15,510
NOVN SW	Novartis 'R'	Health Care	205,542
ROG SW	Roche Holding	Health Care	180,196
SAN FP	Sanofi	Health Care	103,007
AZN LN	Astrazeneca	Health Care	99,503
LONN SW	Lonza Group	Health Care	22,663
SN/ LN	Smith & Nephew	Health Care	18,267
UCB BB	Ucb	Health Care	15,088
MRK GR	Merck Kgaa (Xet)	Health Care	14,025
SOON SW	Sonova N	Health Care	13,263
DIM FP	Sartorius Stedim Biotech	Health Care	12,473
DTE GY	Deutsche Telekom (Xet)	Comm Svs.	79,377
VOD LN	Vodafone Group	Comm Svs.	48,373
TEF SQ	Telefonica	Comm Svs.	41,506
ORA FP	Orange	Comm Svs.	41,475
VIV FP	Vivendi	Comm Svs.	36,579
SCMN SW	Swisscom	Comm Svs.	24,038
BT/A LN	Bt Group	Comm Svs.	27,228
WPP LN	Wpp	Comm Svs.	15,769
ENEL IM	Enel	Utilities	63,006
IBE SM	Iberdrola	Utilities	57,696
EDF FP	Edf	Utilities	41,205
NG LN	National Grid	Utilities	36,648
ENGI FP	Engie	Utilities	35,536
RWE GY	Rwe (Xet)	Utilities	14,087
EDP PL	Edp Energias De Portugal	Utilities	13,238

Source: Bloomberg, IBES, Datastream, Barclays Research. For more information please see our report Cyclicals: Don't rush to buy the dip, 15 May 2019

Energy – Overweight

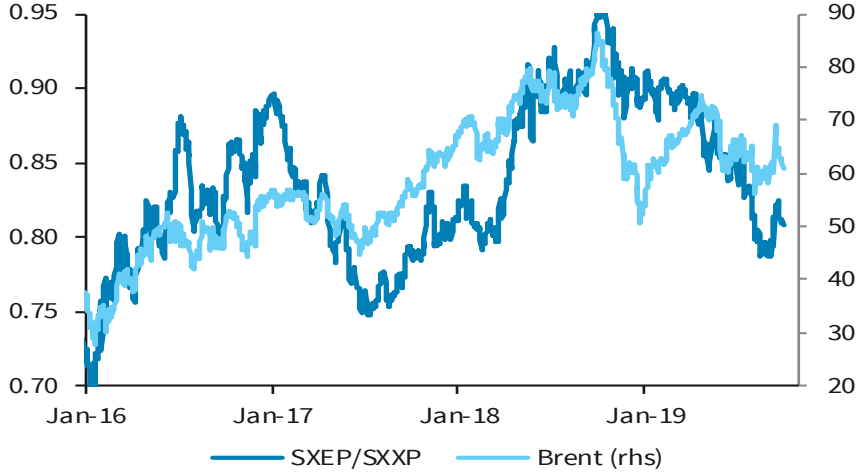
- Energy is a good compromise between cyclicality and defensiveness (~6% well covered yield), in our view.
- We think the recent negative price action is overdone and keep our overweight in place.
- The sector continues to lag resilient EPS.
- Speculative oil longs have been cut.
- Demand so far resilient despite slowing economic data.
- Supply may increase towards year-end, but for now OPEC+ and geopolitics are providing an effective floor to the oil price and could deepen cuts towards year end.
- Cash returns to shareholders are strong and well covered by FCF generation.

Energy sector is underperforming its EPS relative



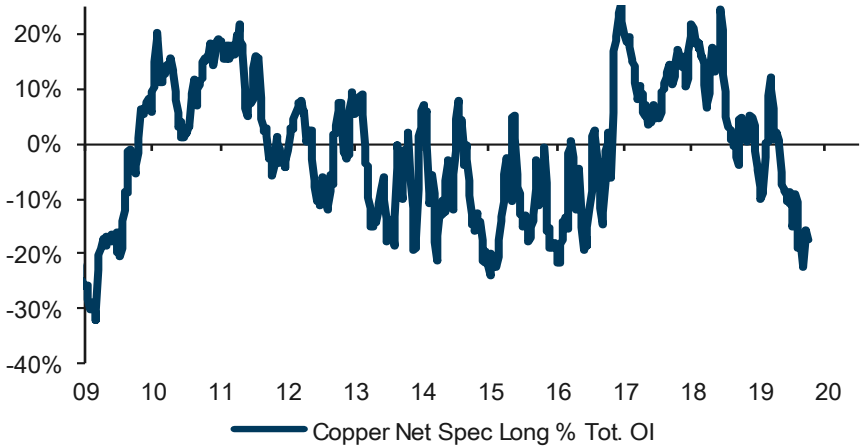
Source: MSCI, Refinitiv, IBES, Barclays Research

Oil sector now marginally behind oil price



Source: Bloomberg, Barclays Research

Crude speculative interest has unwound

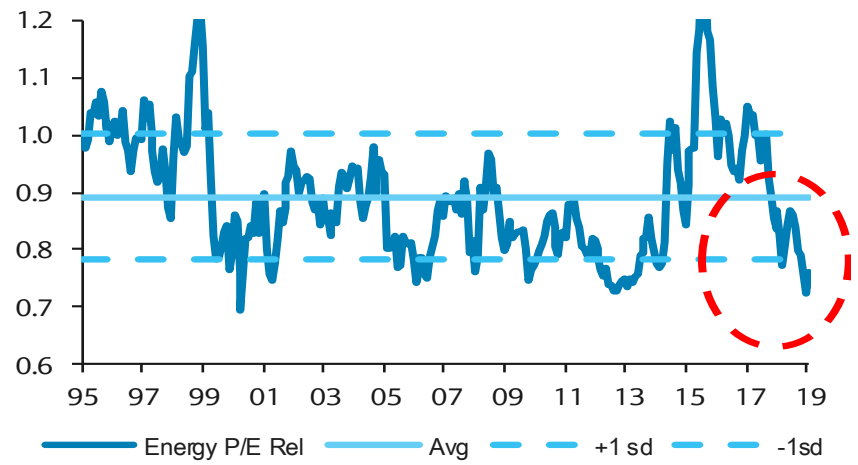


Source: CFTC, Bloomberg, Barclays Research

Valuations are at all-time lows, yield is attractive and well covered

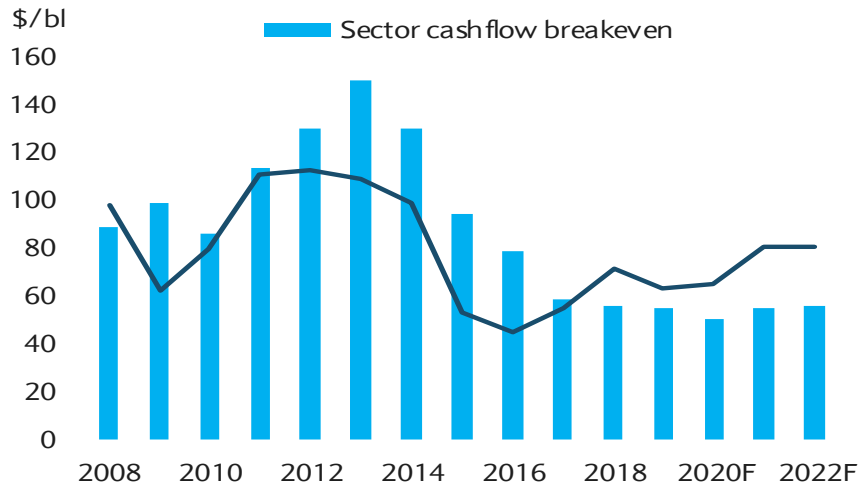
- Sector valuations have fallen back to all-time lows (P/E relative <-1 std deviation).
- Sector to remain cash flow positive post capex and dividends, as capital discipline is strong.
- Energy is offering a ~6% dividend yield at present, which is particularly attractive in the current backdrop of subdued bond yields and provides a defensive element to owning energy.
- Our European energy sector analysts have $60 Brent in their company earnings models for 2019 (avg ytd $65), and $60 for 2020.

Energy P/E has cheapened as sector price has fallen despite resilient earnings



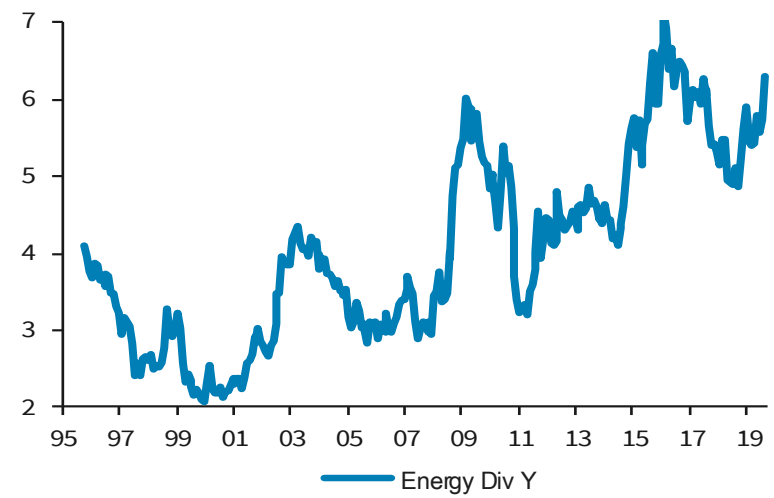
Source: Refinitiv, MSCI, IBES, Barclays Research

Strong FCF generation covers capex & cash returns



Source: Barclays European Oil & Gas Research

Dividend yield is high and well-covered

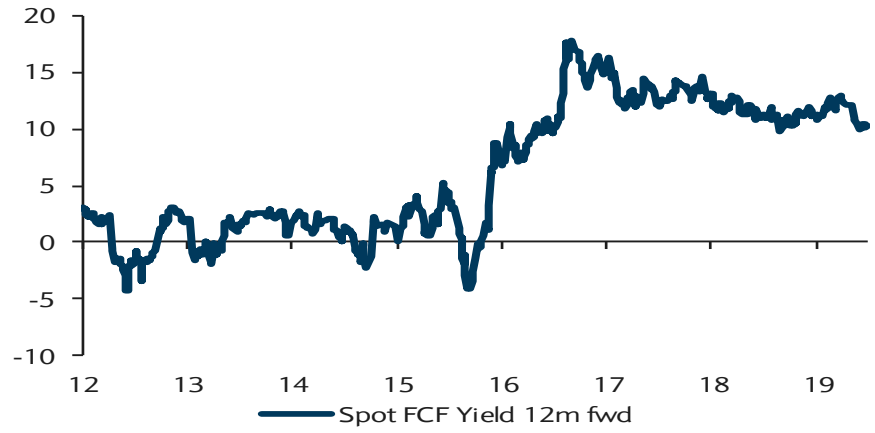


Source: Refinitiv, MSCI, IBES, Barclays Research

Materials – Marketweight (Mining at MW, Chemicals at UW, Construction at OW)

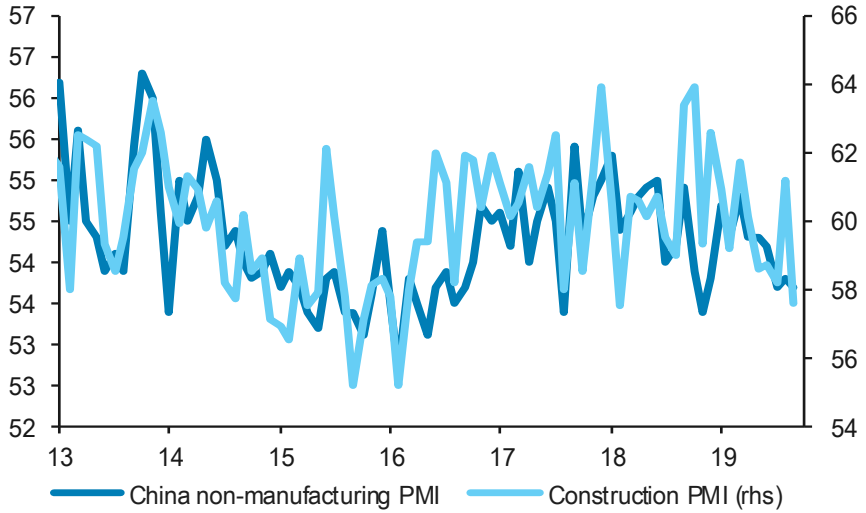
- We upgraded Materials to OW in November (**8**) but brought back to MW in early August (**9**). We are OW Construction Materials, MW Mining back and UW Chemicals.
- China-US trade war escalation has sent iron ore sharply lower in the last 3m, but inventories look to have normalized lower and back to average which is positive.
- Targeted stimulus in China may help but we don't expect significantly. Property & construction remain strong and there could be some infrastructure projects in Q4.
- Mining valuations are attractive (Mining spot FCF yield at 10%), and the sector offers self-help potential.

Mining FCF yield remains attractive at 10%, but has dropped ~3% over last 12m



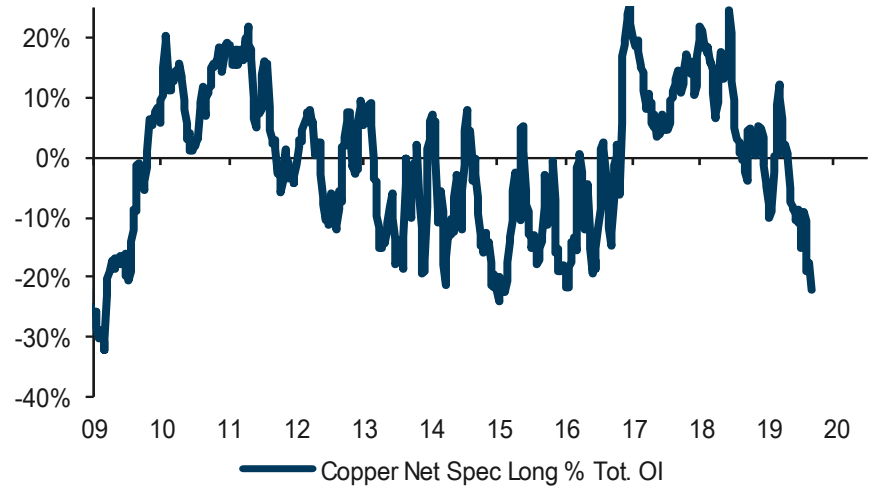
Source: Barclays Mining Research

China construction PMI decelerating – stimulus to come?



Source: Bloomberg, Barclays Research

Net Speculative copper short increased further



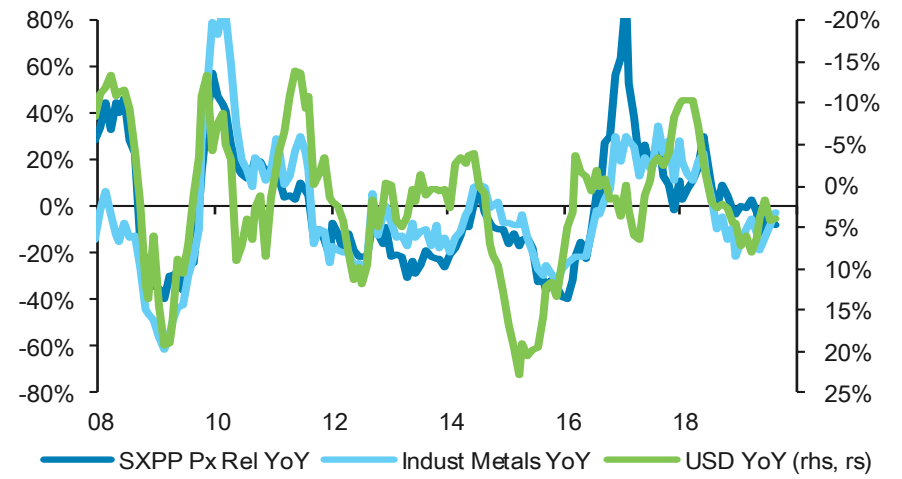
Source: CFTC, Bloomberg, Barclays Research

(8), (9), (10): please refer to slide 184 for hyperlinks to previously published research reports.

Mining – Marketweight

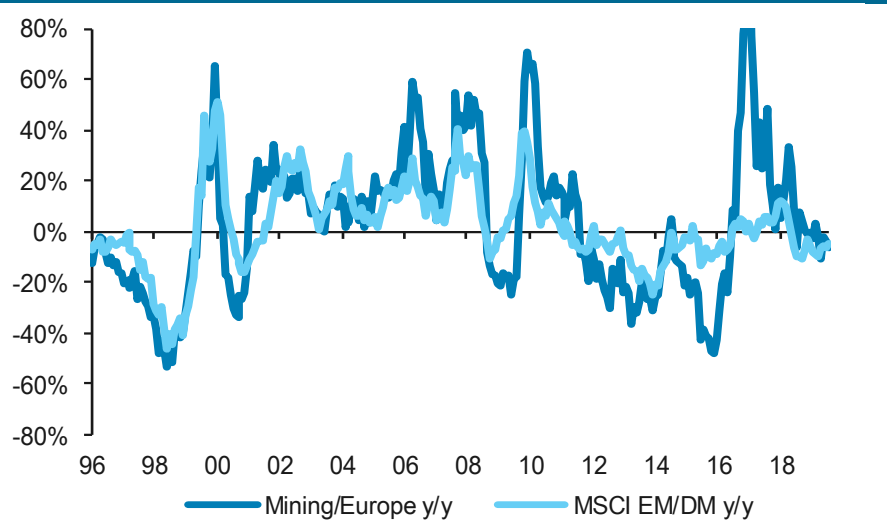
- Miners significantly lagged Iron Ore prices ytd, but look more in line post large drop in iron ore last month.
- Iron Ore is 2.5x more important to sector EBITDA than Copper.
- Commodity prices have fallen most recently in the re-flaring trade war, a stronger USD doesn't help either, but inventories look to have adjusted lower to seasonal average which is healthier.
- EM/DM is highly correlated to miners vs. market.

Mining sector performs with higher metals and weaker USD



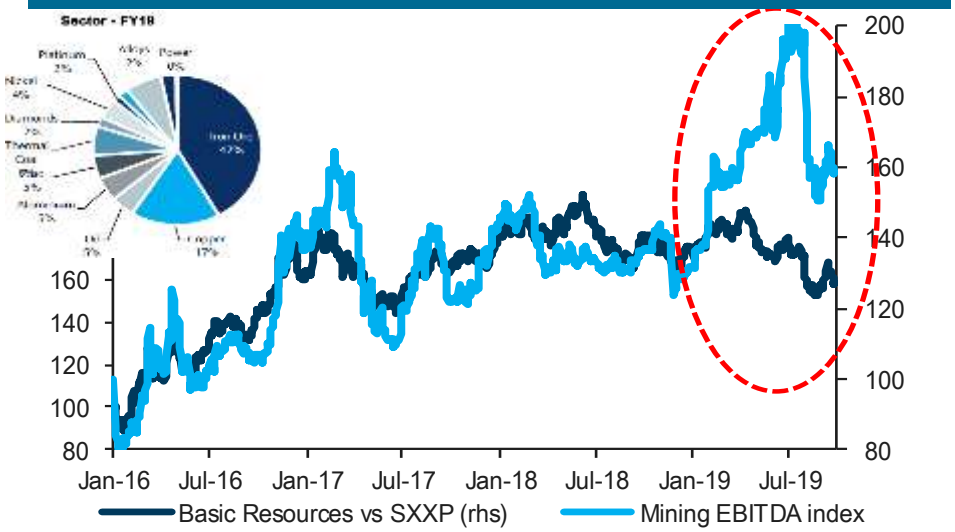
Source: Bloomberg, Barclays Research

Mining relative to the market and EM/DM highly correlated



Source: Refinitiv, Barclays Research

EBITDA split: Iron Ore 2.5x more important than Copper

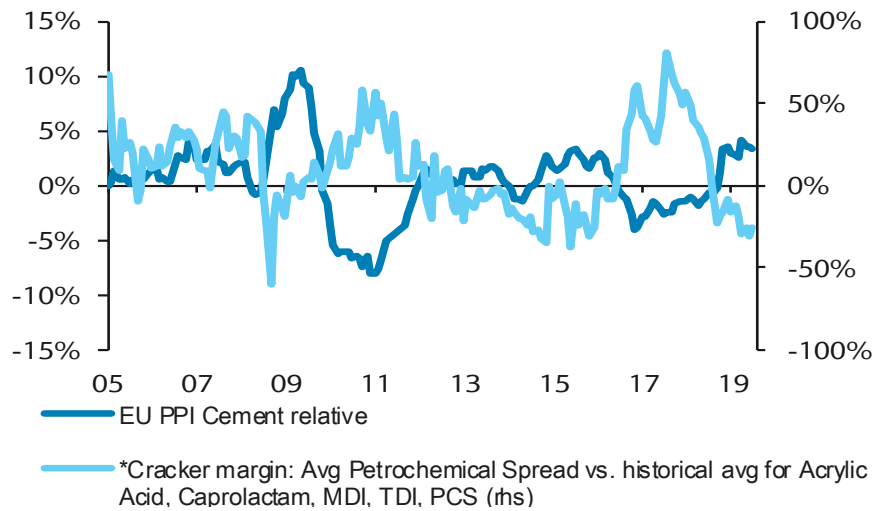


Source; Barclays Mining Research, Bloomberg

Prefer Construction Materials to Chemicals

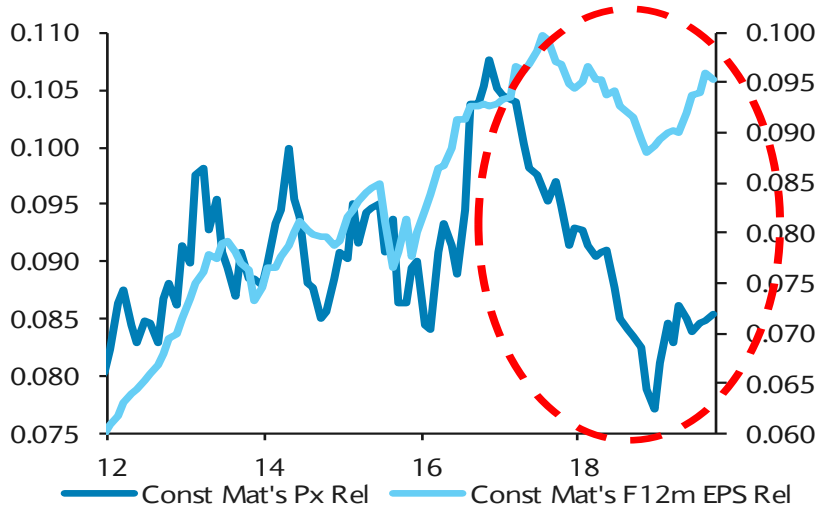
- Chemicals overall continue to perform well ytd (helped by large defensive weighting in Industrial Gases) despite poor earnings seasons in Q1 & Q2. EPS is significantly declining but the sector remains resilient. We keep Chemicals short as we don't see an H2 rebound helping volumes, pricing or earnings. Q3 could see further EPS downgrades.
- Construction Materials offer a good exposure mix to EM/China, and Domestic Europe. They are delivering price increases (cement pricing is recovering) and we demand is supported by pro-housing policy in China.

Cement PPI has rebounded, Cracker spreads continue lower



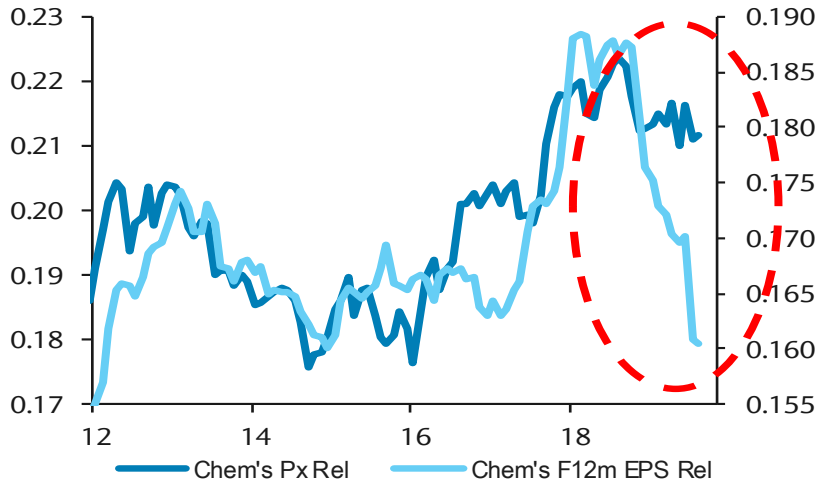
Source: ICIS, Bloomberg, Barclays Research

Construction price is significantly lagging its EPS…



Source: MSCI, Refinitiv, IBES, Barclays Research

…while Chemicals price is far outpacing its EPS

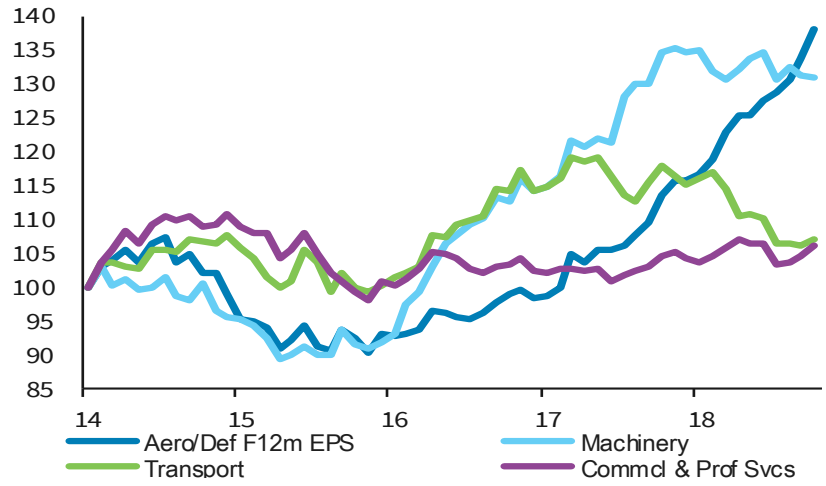


Source: MSCI, Refinitiv, IBES, Barclays Research

Industrials – Underweight (Capital Goods UW, Aerospace OW, Transport UW)

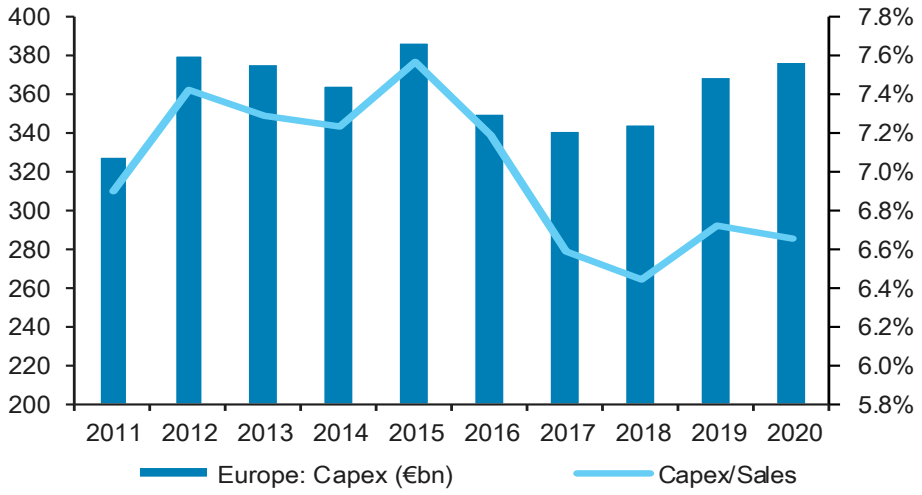
- We keep Industrials at UW – they are expensive and trade at/near peak margins, and we have questions over end market demand.
- Within this, we are positive on Aerospace & Defense, but cautious on the rest of Capital Goods, Transport and Commcl & Prof Services.
- Pressure in short cycle and general industrial continues – driven by weakness in European end markets rather than China/trade war related.
- We expect only limited/targeted stimulus in China – no policy catalyst to lift growth.

Aero Earnings are still growing but rest of sector looks to be flat at best



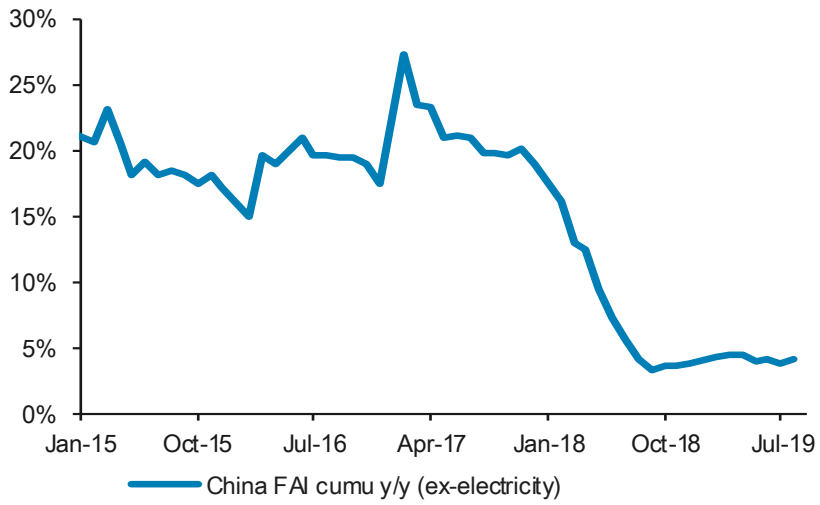
Source: MSCI, Refinitiv, IBES, Barclays Research

Barclays analysts expect moderate capex recovery



Source: Barclays Research, Worldscope. Note: Barclays estimates for the coverage universe (ex Fin)

China FAI is bottoming out, but significant stimulus looks unlikely

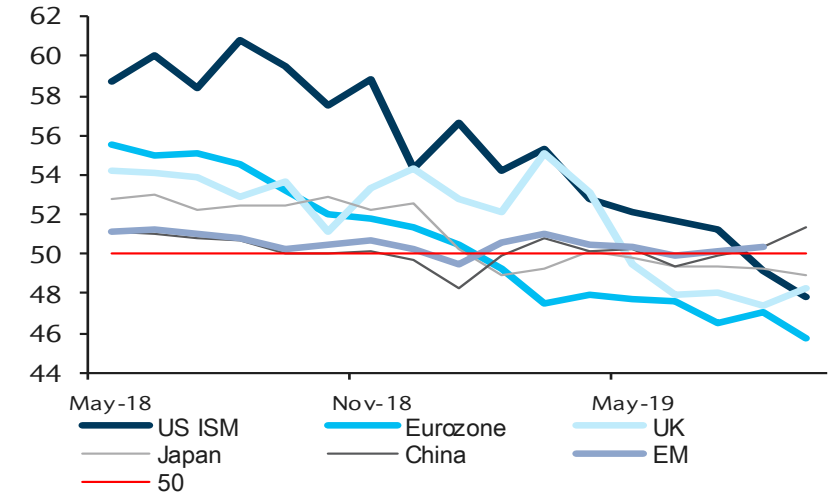


Source: Bloomberg

Manufacturing indicators continue to deteriorate, while valuations are at highs

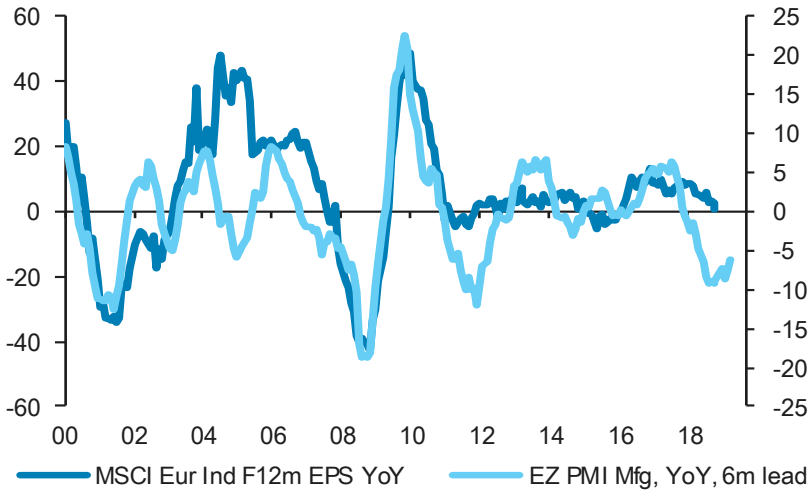
- Lead indicators such as Manufacturing PMI's continue to deteriorate globally, and suggest earnings growth will turn negative in the future.
- The sector is trading expensive relative to the market.

Manufacturing recession continues to broaden globally



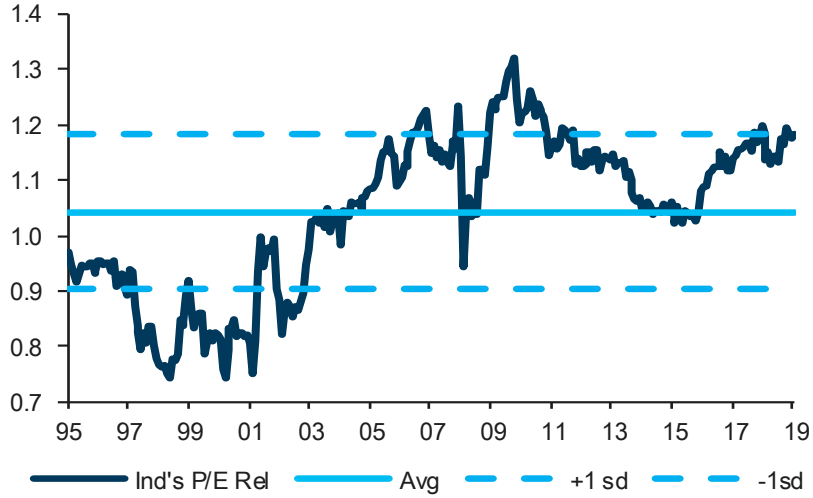
Source: Haver, Barclays Research

The rollover in manufacturing PMI points leaves Industrials EPS Growth looking stretched



Source: Bloomberg, IBES, Refinitiv, Markit

Industrials relative P/E is looking stretched

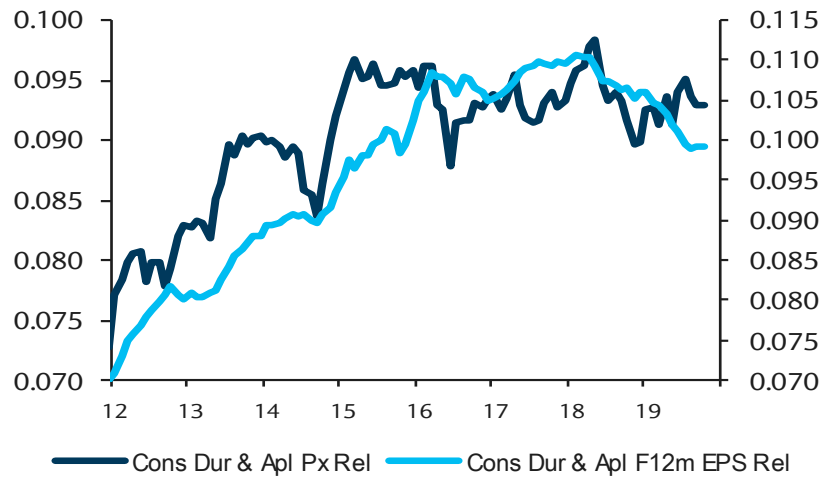


Source: MSCI, Refinitiv, IBES, Barclays Research

Consumer Discretionary – Marketweight

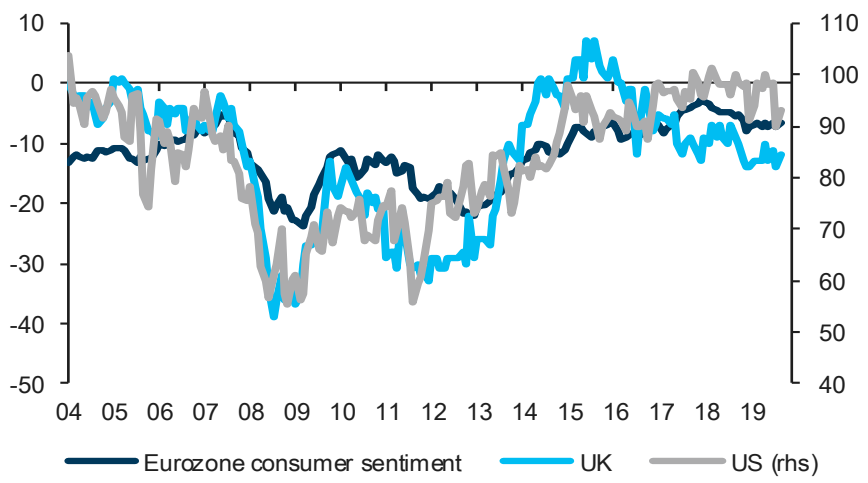
- We are MW Consumer Discretionary and all of the component subsectors. Consumer fundamentals are supportive and drivers of spending – employment, fiscal policy and financing conditions – are resilient in the Eurozone, UK and US for now.
- We note a tick down in consumer sentiment last month and will continue to monitor.
- Many Discretionary subsectors such as Autos and Retail are structurally challenged and are getting less profitable. Luxury Goods was our key OW this year but as valuations have become expensive while macro risks are rising, we cut it to MW in early August (**11**).

Consumer Discretionary relative performance and earnings



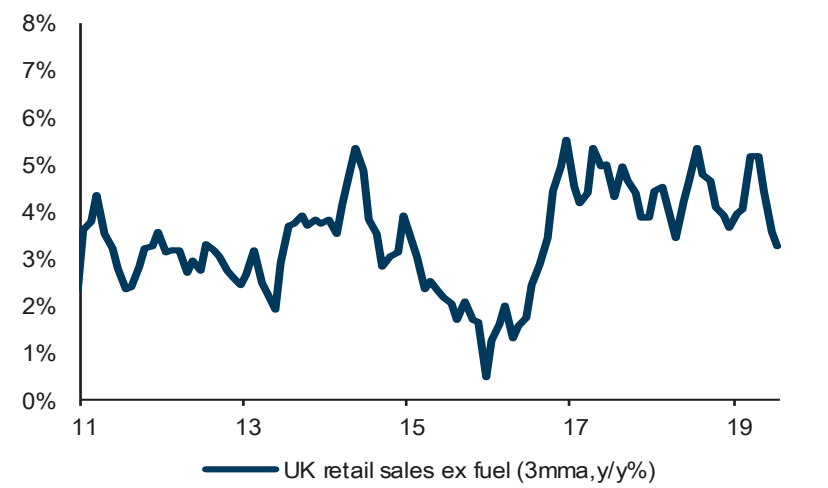
Source: MSCI, Refinitiv, IBES, Barclays Research

Consumer sentiment has weakened most recently



Source: Bloomberg

UK spending is growing but ticking down



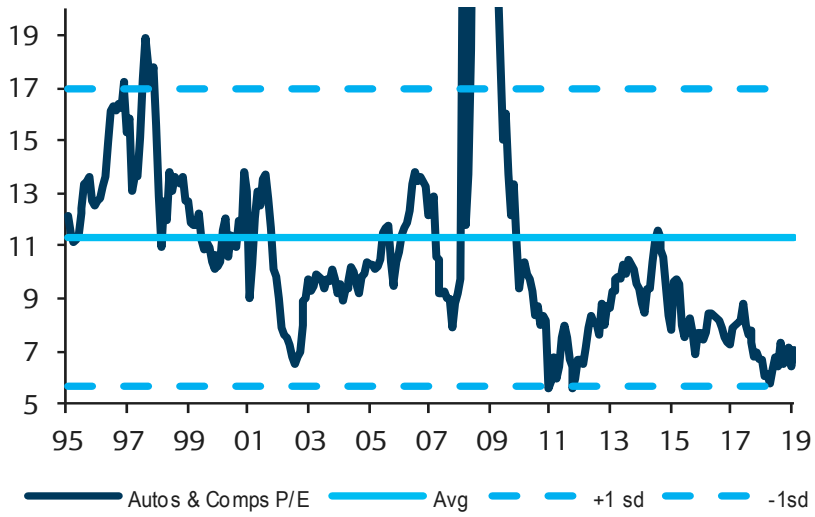
Source: ONS

(11): please refer to slide 184 for hyperlinks to previously published research reports.

Autos are cheap and under-owned, but structural and political headwinds remain

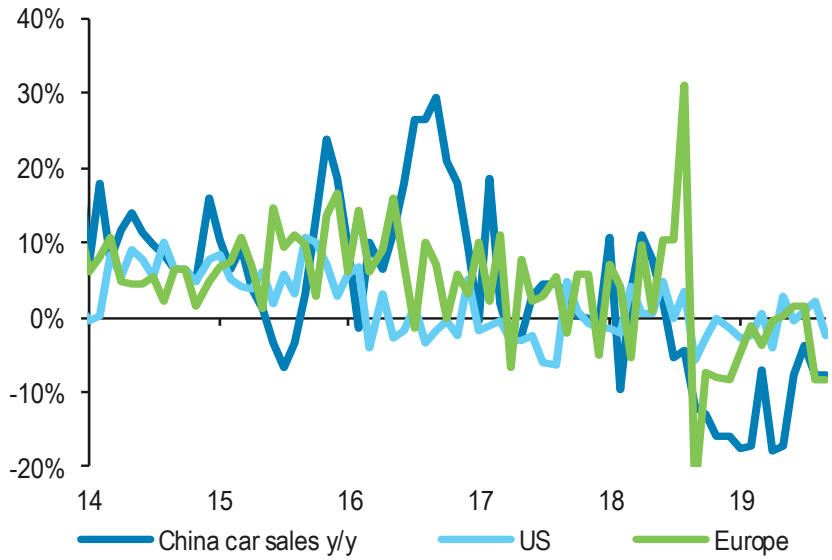
- Autos rebounded relative to the market early Sept but have since given most of the outperformance back.
- Disappointingly, sales growth in China remains deeply negative despite starting to annualise last year's negative growth rates. We don't see stimulus helping in China this year.
- Sales growth has deteriorated again in Europe again although remains around flat in the US.
- Possibility of further volume reductions next year.
- Secular headwinds such as the shift to electric drive trains, ride hailing and autonomous driving are not going away any time soon, and imply lower profits going forward even once capex winds down given higher value per car.
- An increase in US tariffs on European cars is not our base case, but the threat remains and uncertainty hanging over the sector is unlikely to diminish.
- Valuation is low but unlikely to re-rate with ongoing uncertainty.

Autos valuations have de-rated sharply due to structural & cyclical headwinds, but a catalyst for re-rating is missing



Source: MSCI, Refinitiv, IBES, Barclays Research

Car sales growth negative in China & Europe, marginally down in US

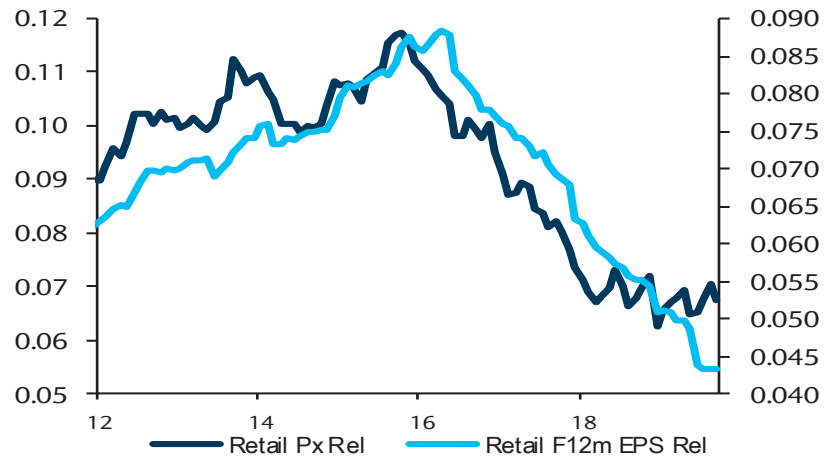


Source: Bloomberg

MW Luxury Goods – Secular growth intact, but valuations are stretched

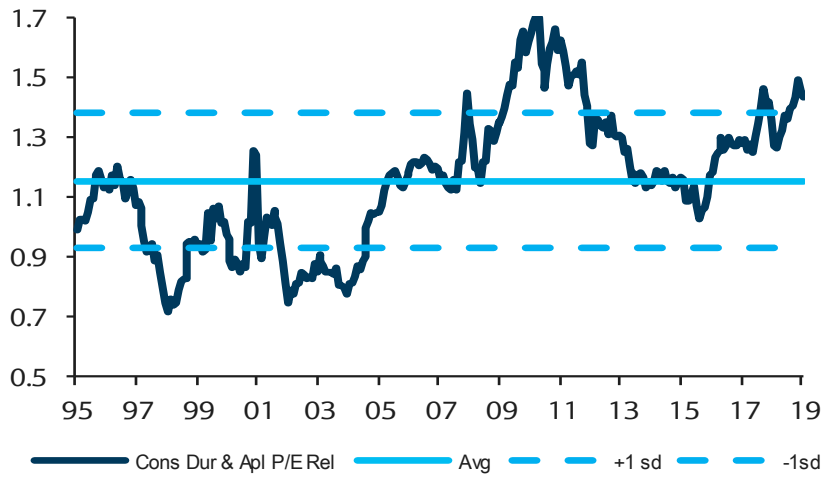
- We recently cut Luxury Goods from OW to MW (**11**). Valuations are stretched, even though we expect earnings to be relatively resilient in 2019.
- The Chinese consumer is holding up, but CNY weakness, rising trade uncertainty and HK protests are headwinds.
- The Retail subsector performed well despite significant earnings cuts. It continues to face both cyclical and structural headwinds.

Retail is outperforming poor earnings dynamics



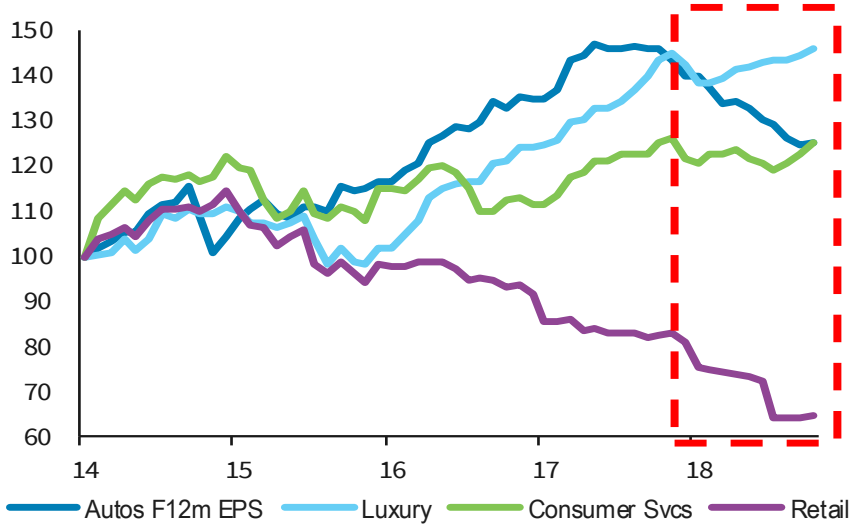
Source: MSCI, Refinitiv, IBES, Barclays Research

Luxury Goods are (very) expensive



Source: MSCI, Refinitiv, IBES, Barclays Research

Discretionary subsectors EPS momentum – winners vs. losers

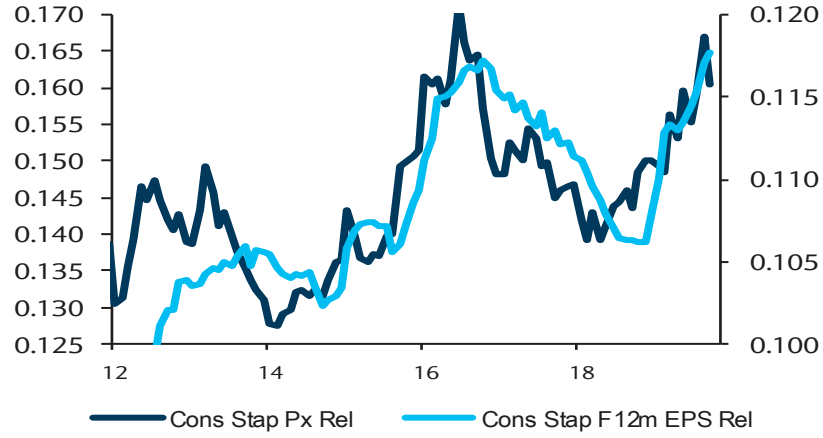


Source: IBES, Refinitiv, Barclays Research

Consumer Staples – Underweight

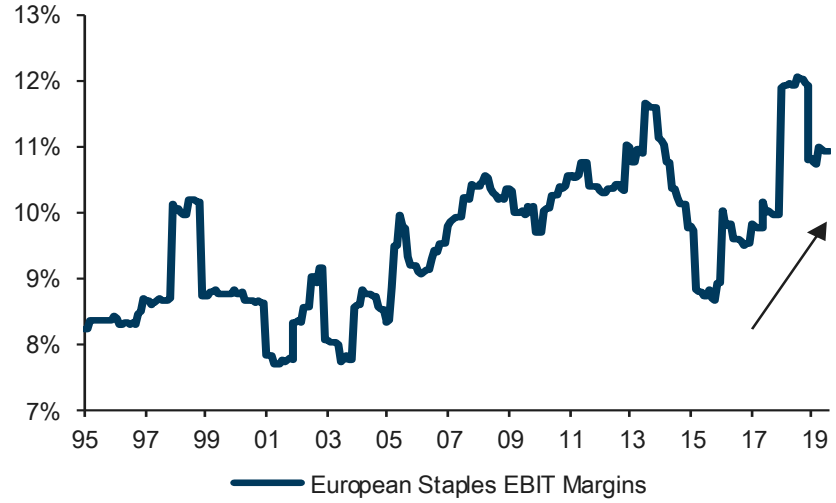
- We are underweight Consumer Staples as it is the most expensive defensive sector and has fully reflected the dramatic move lower in bond yields as investors have scrambled for quality & growth.
- The sector has good EPS momentum but price looks to have more than fully discounted this.
- Staples earnings should be more immune to the cyclical pressures than many other sectors and profit margins remain strong, but soft inflation may cause headwinds in the medium term.

Consumer Staples relative performance and earnings



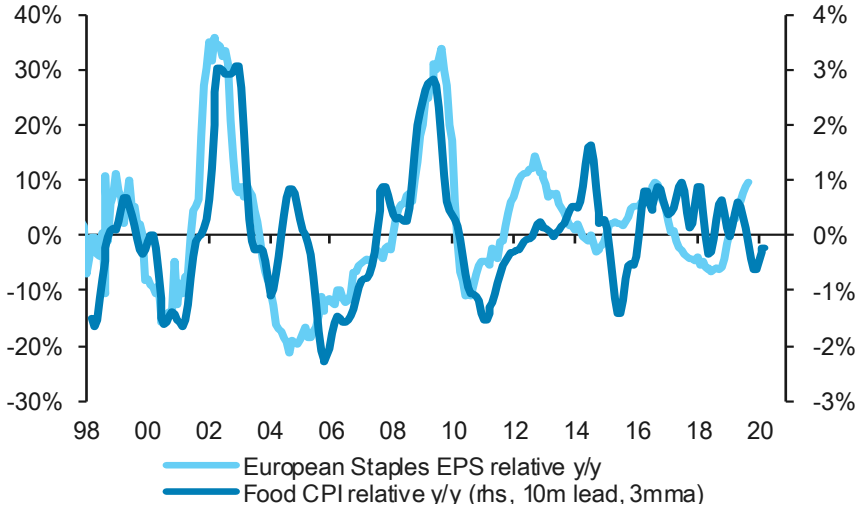
Source: MSCI, IBES, Refinitiv, Barclays Research

Margins have been improving…



Source: Worldscope, Barclays Research

… but food inflation remains soft

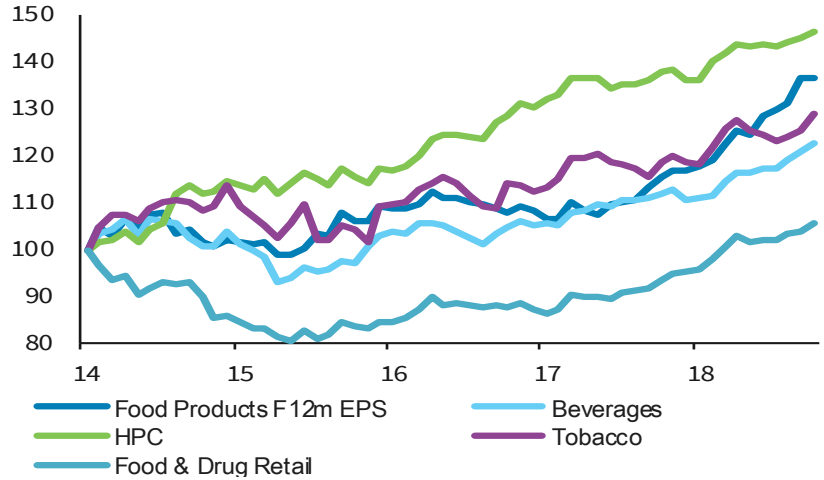


Source: IBES, Refinitiv, Eurostat

Expensive bond proxy

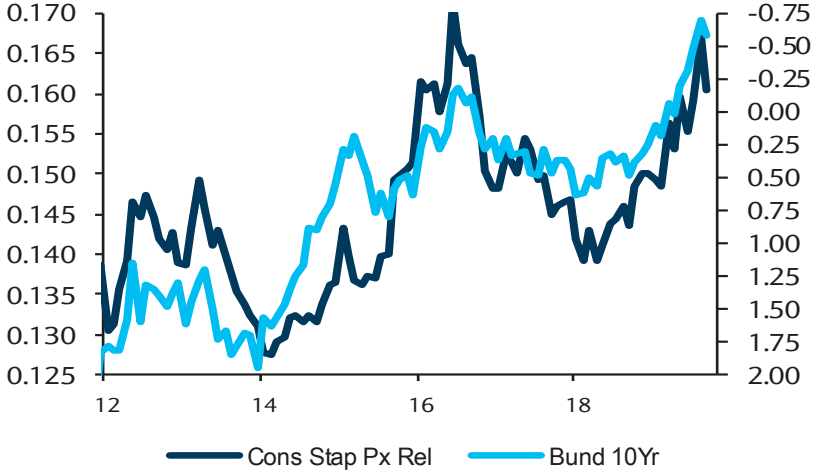
- Staples typically move in the opposite direction to bond yields and the relationship between the two remains strongly inverse.
- The sector's relative performance has continued to follow bund yields lower ytd, although organic sales growth has mostly been strong.
- We find Staples' valuation demanding. However, without a catalyst to send bund yields higher, the sector can stay expensive.

Subsectors have all been growing earnings this year



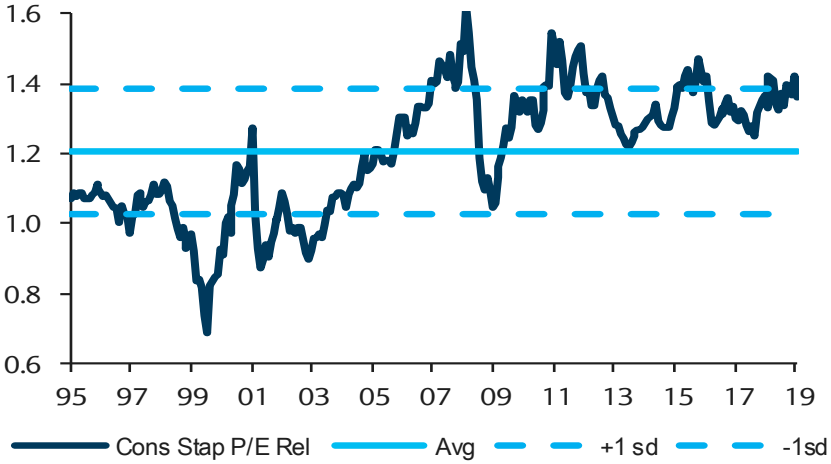
Source: EPFR, Barclays Research

Staples fully discounted the move lower in bund yield



Source: MSCI, IBES, Refinitiv, Barclays Research

Staples P/E relative remains elevated

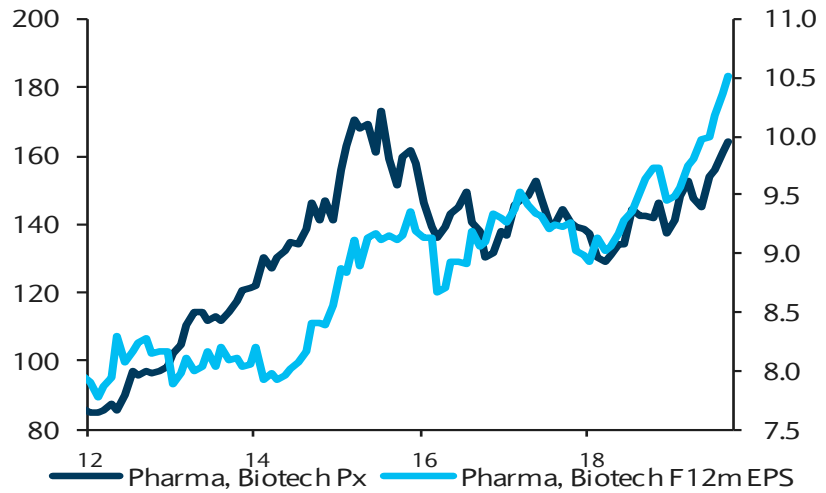


Source: MSCI, IBES, Refinitiv, Barclays Research

Healthcare – Overweight

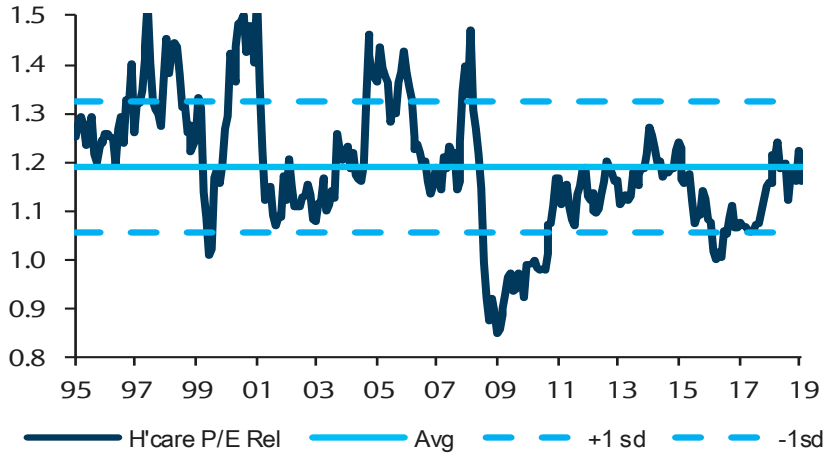
- We upgraded Healthcare to OW from UW in early May (**12**). The sector had fallen a lot even though relative earnings were improving. We still like the sector even though performance has recovered somewhat.
- Healthcare is one of the cheaper defensive growth sectors. It had good Q1 & Q2 earnings seasons and offers good visibility for the rest of 2019.
- 'Medicare for all' is on the manifesto for many 2020 Democratic candidates; however, we believe it will affect the US managed care/services companies more than European Pharma companies.

Pharma relative performance and earnings



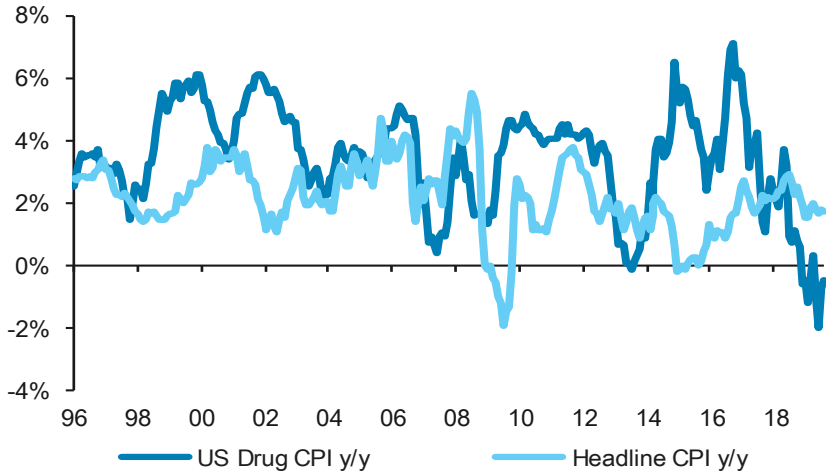
Source: MSCI, IBES, Refinitiv, Barclays Research

Healthcare valuations are around long run average



Source: MSCI, IBES, Refinitiv Barclays Research

US Drug pricing has rolled over but this is more an issue for Healthcare providers than Pharma companies

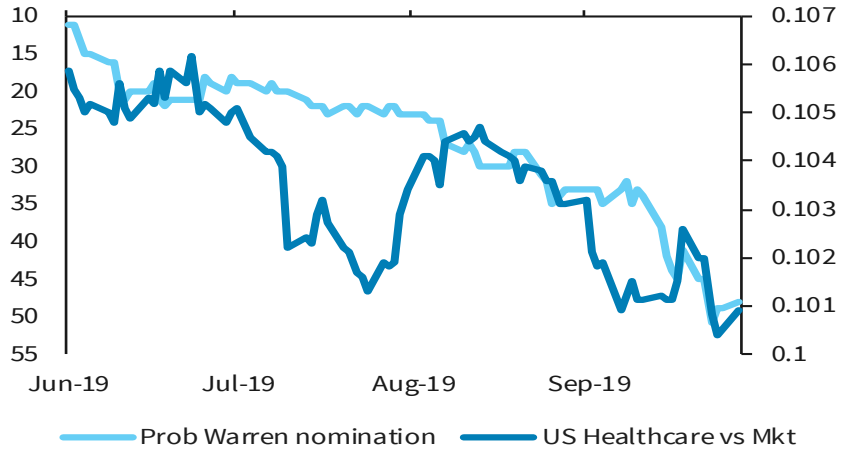


Source: Bloomberg

The sector is a cheap bond proxy and benefits from weaker EUR

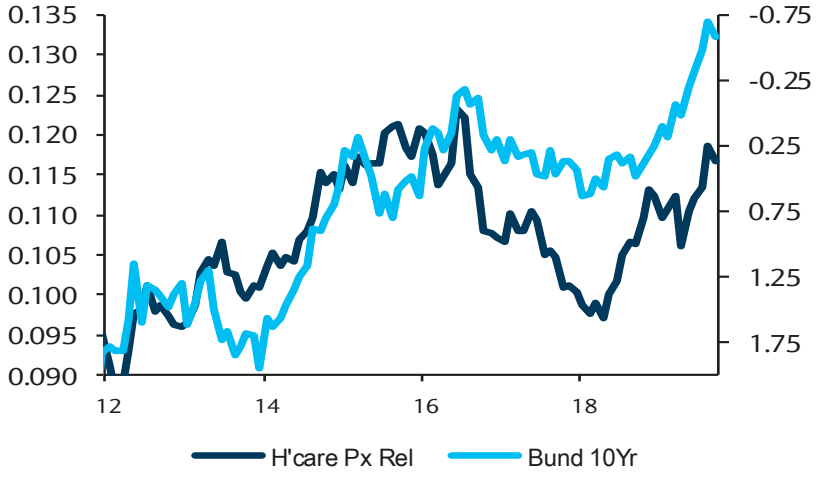
- Healthcare's relative performance is typically strongly inversely correlated to bond yields
- However unlike other defensive sectors, Healthcare has recently underperformed bund yields.
- European Healthcare continues to benefit from the weaker Euro.

US political risk is a headwind



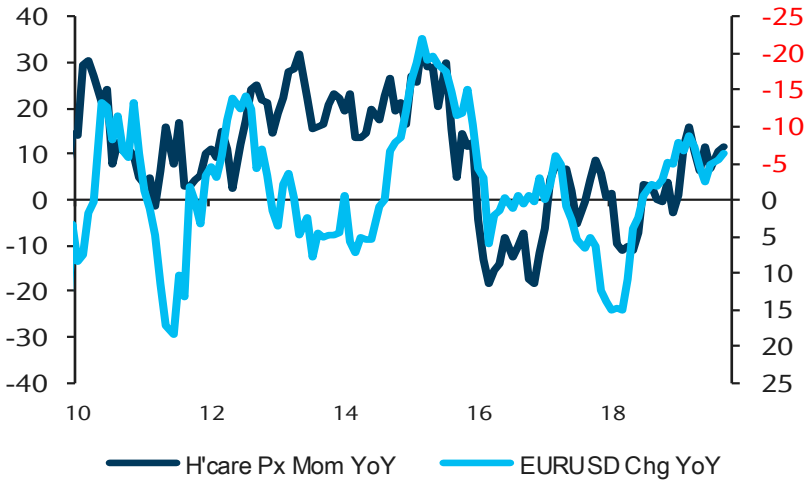
Source: Bloomberg, Barclays Research

Healthcare has significantly lagged the move in bund yields



Source: MSCI, IBES, Refinitiv, Barclays Research

A weaker Euro is a positive for the sector

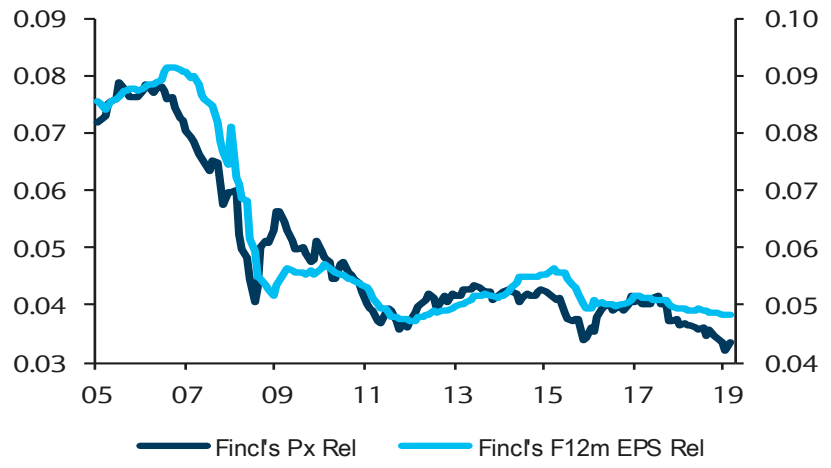


Source: MSCI, IBES, Refinitiv, Barclays Research

Financials – Marketweight: Stabilizing bond yields help Banks…

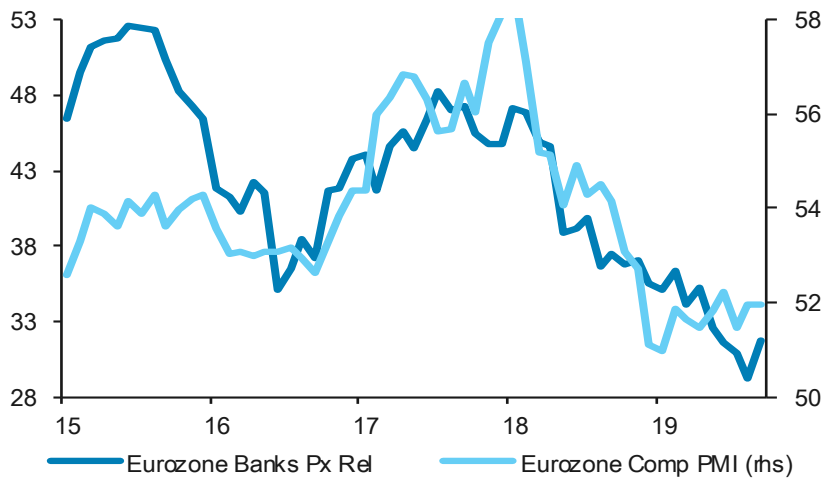
- We are MW Financials, with a preference for Insurance (OW) over Banks and Div Fins (MW).
- Banks fell more than 25% in 2018 and are flat ytd. The sector is consensus UW and is trading on cheap multiples.
- Falling bond yields are hurting the sector profitability, but the recent stabilization helped the rebound.
- Banks continue to face many structural headwinds that constrain their profitability.

MSCI Europe Financials relative performance and earnings



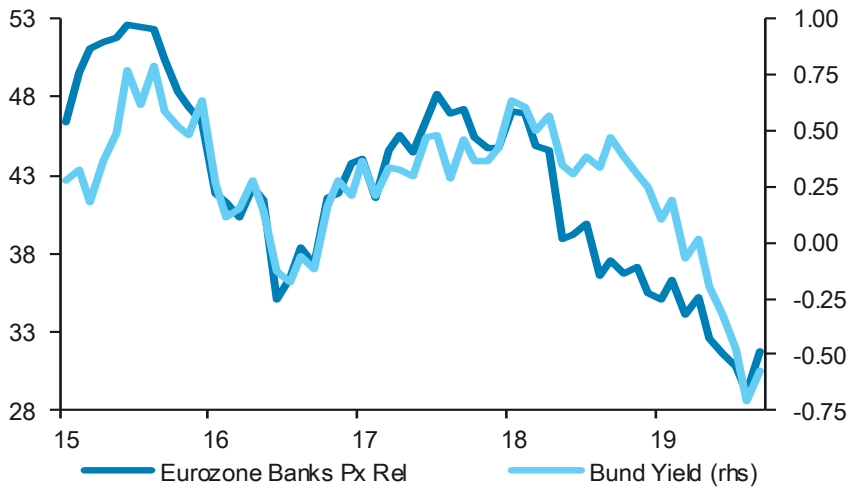
Source: MSCI, IBES, Refinitiv, Barclays Research

Activity data matter for Banks



Source: Refinitiv, Markit, Haver

Yields (and banks) follow activity data

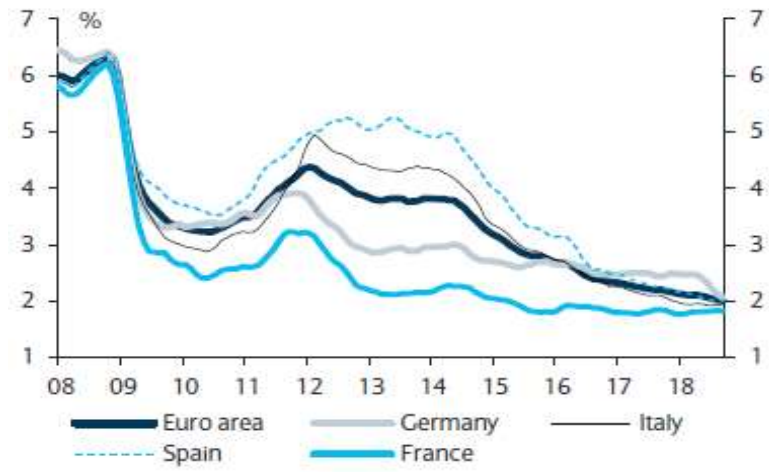


Source: Refinitiv, Markit, Haver

Dovish ECB does not help banks equities, tiering only helps at the margin

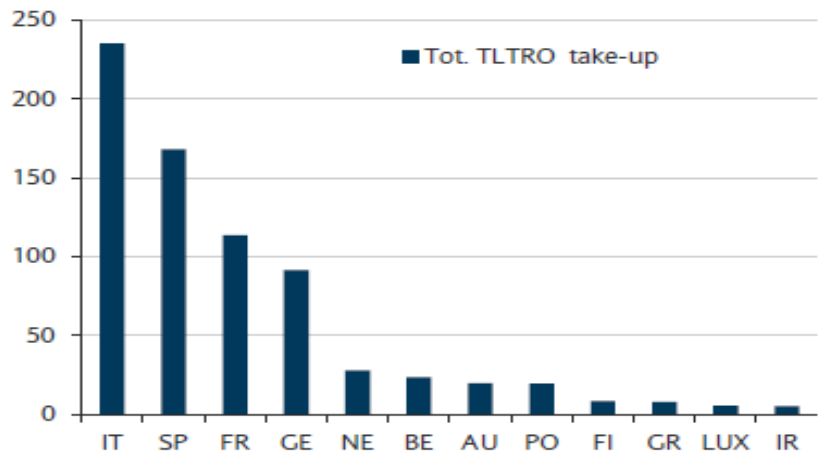
- The current backdrop of low rates and low growth is negative for Banks. Even though the terms of the new TLTRO were generous, banks equities have not benefited.
- As the ECB opened the door to more easing earlier this year, Banks equity performance worsened, while credit rallied.
- Mitigating measures/tiering put in place are helpful, but unlikely to offset the full negative impact of further negative rates.

Bank lending rate to SMEs fell thanks to ECB action



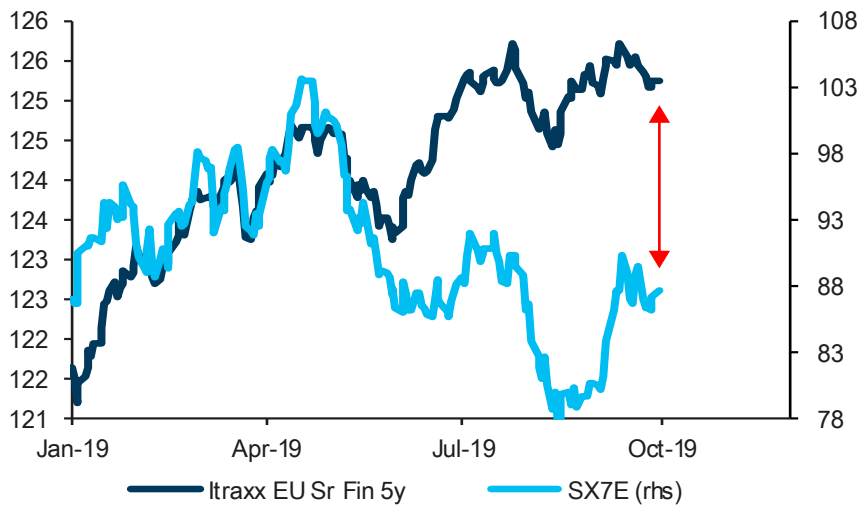
Source: ECB, Barclays Research

Peripheral countries are the larger TLTRO borrowers (€bn)



Source: ECB, Barclays Research

EU Banks equities performance has decoupled from credit recently

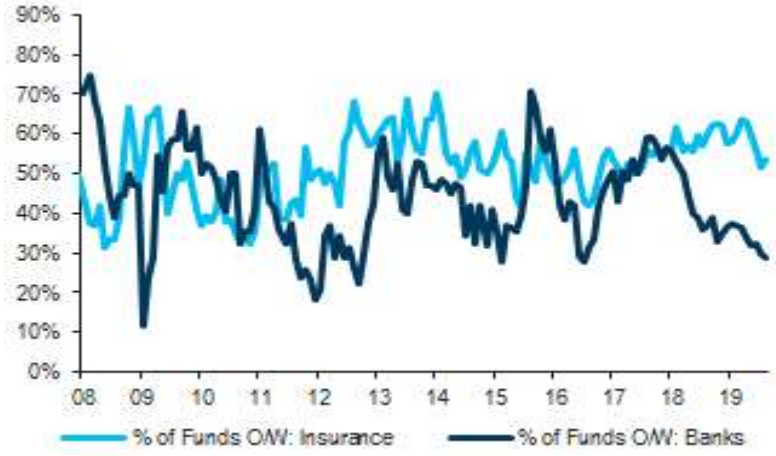


Source: Bloomberg

Banks' valuations are cheap, sector is a consensus UW

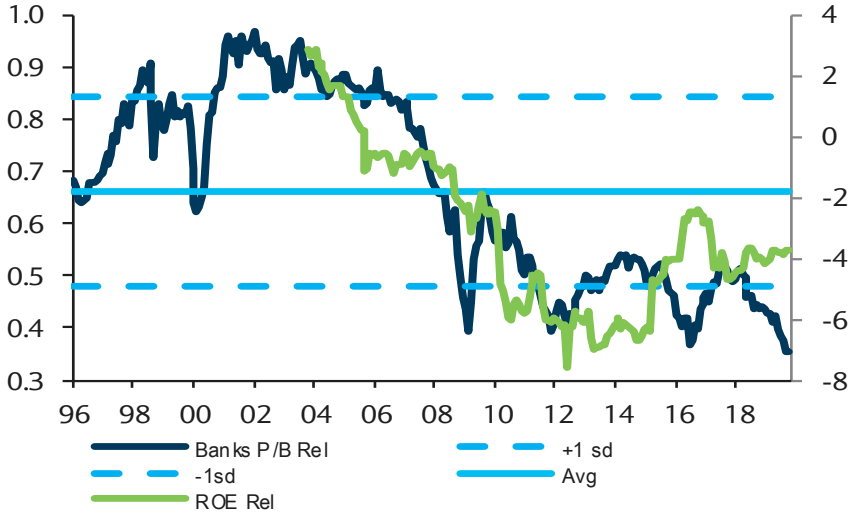
- While Banks still face many cyclical and structural headwinds, their valuations appear to be pricing in a lot of negativity already. Both P/B and P/E relative are near the bottom of the historical range at present. But it is difficult to argue for a re-rating absent activity and yields picking up.
- The sector overall looks to be around average on positioning, but this belies an UW banks and OW Insurance position if we look at sub sectors.

Fins overall neutral but investors OW Insu & UW Banks



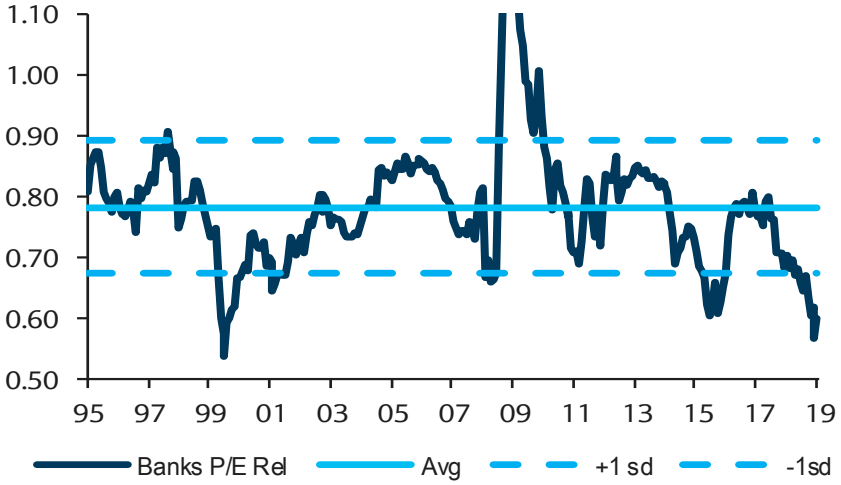
Source: EPFR, Barclays Research

European Banks P/Book vs. ROE relative is attractive…



Source: MSCI, IBES, Refinitiv, Barclays Research

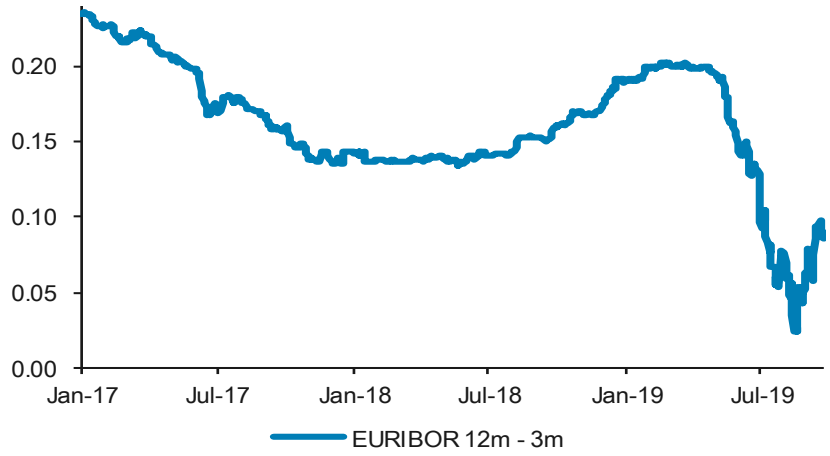
…as is P/E relative



Source: MSCI, IBES, Refinitiv, Barclays Research

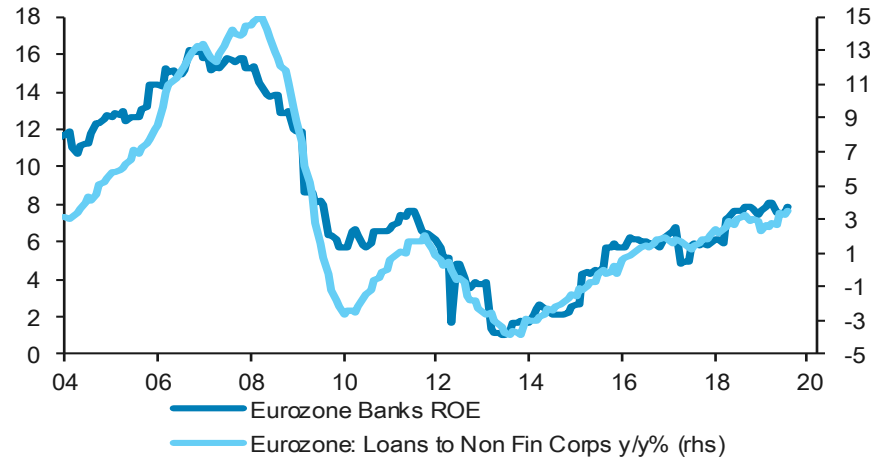
Curve is flattening again, demand for loans low, banks tightening lending standards, loan growth remains anaemic

Euribor curve fell sharply but has since recovered some



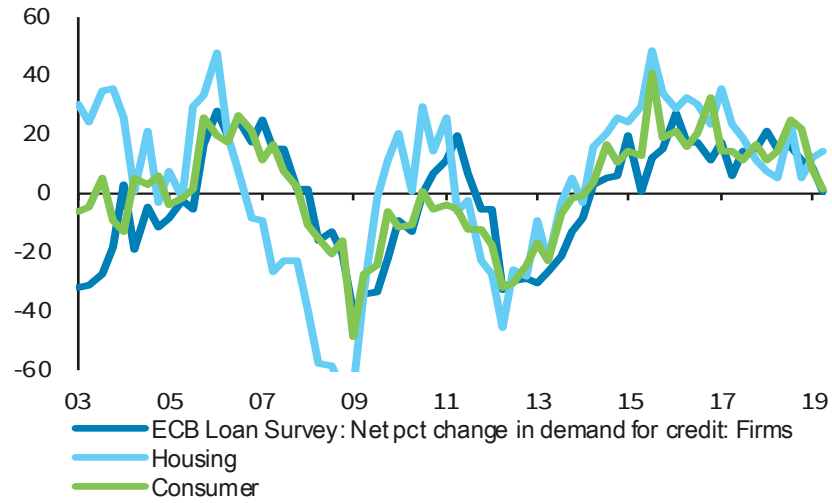
Source: Bloomberg, Barclays Research

Softer lending growth is problematic for ROE



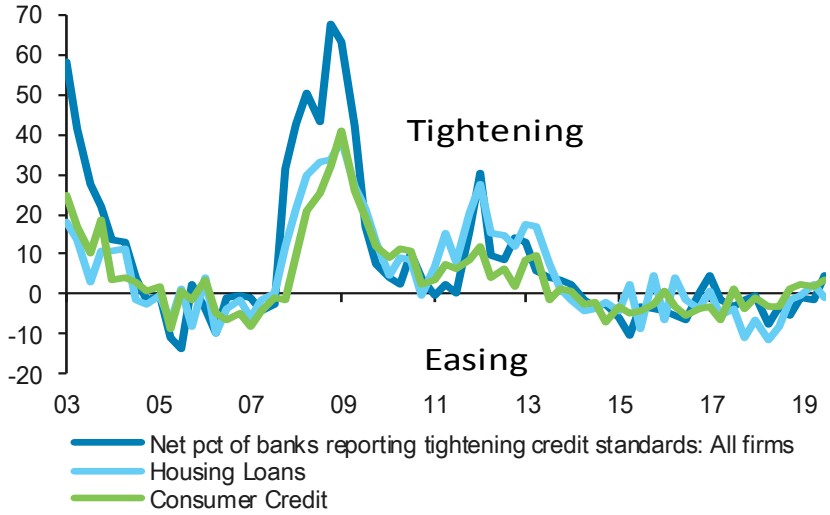
Source: Refinitiv, Eurostat

Demand for loans has fallen to net 0% demand…



Source: Refinitiv, Barclays Research

…Meanwhile banks look to be tightening lending standards

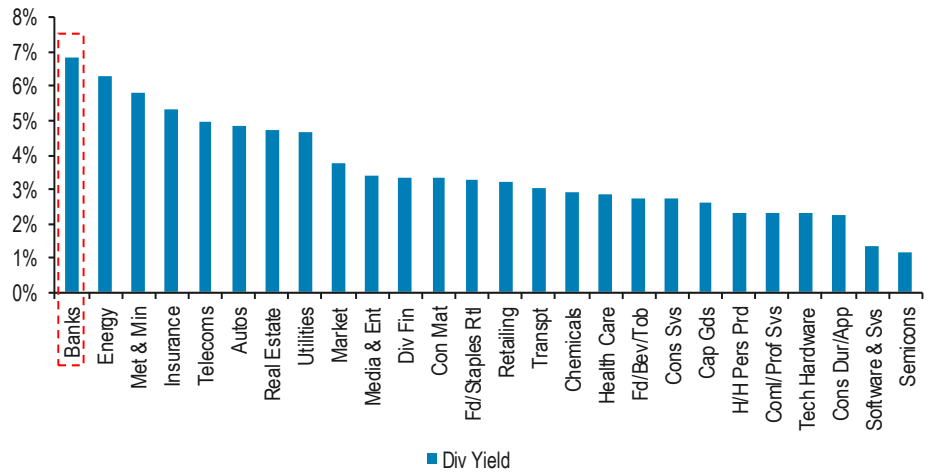


Source: Refinitiv, Barclays Research

Dividend yield looks attractive, but doubts remain on sustainability

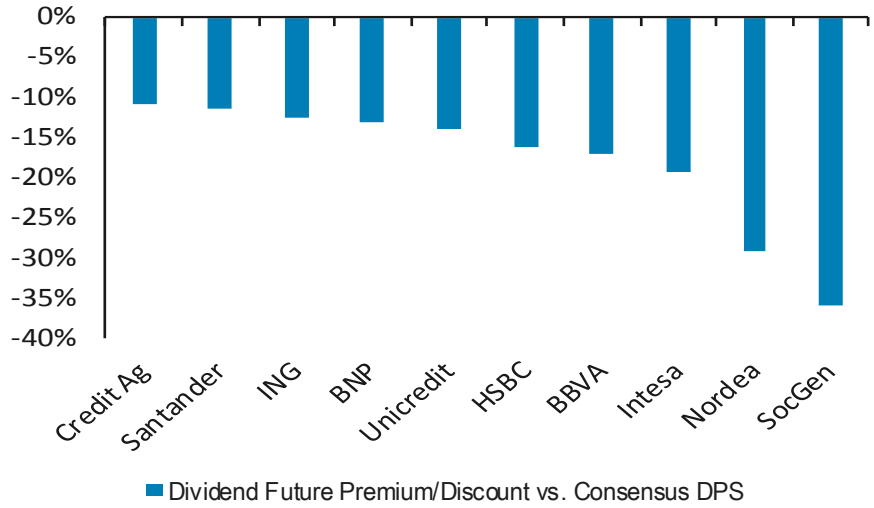
- Banks' ~6% dividend yields looks attractive and is the highest of all the European sectors. Relative to the overall market, Bank's dividend yield is near the highest on record.
- However, the high dividend offered by the banks sector as a whole may be masking some idiosyncratic stock level dividend risk.
- Looking at dividend futures term structure, the market implies bigger cuts for the banks sector then the Euro Stoxx 50.

Banks offer the highest dividend yield of European sectors



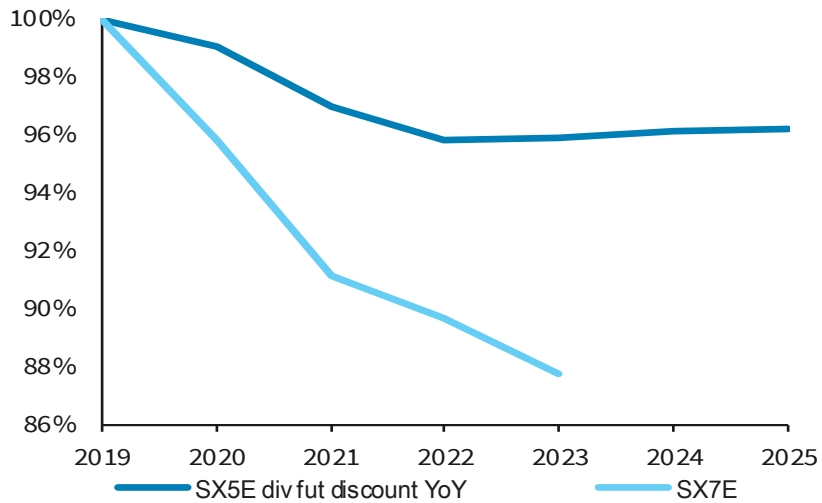
Source: Refinitiv, Barclays Research

Dividend futures vs. 2020 consensus dividend per share: market implying some risk to dividends



Source: Bloomberg, Barclays Research

Bank's dividends considered more 'at risk' than the wider market

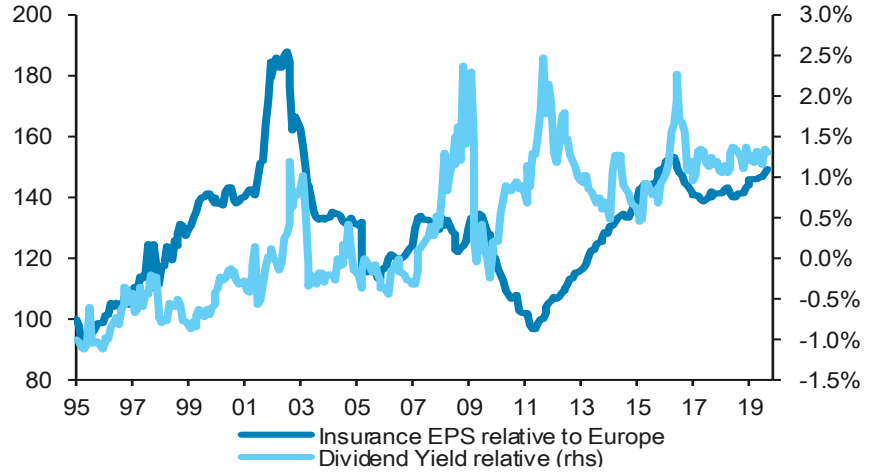


Source: Bloomberg, Barclays Research

OW Insurance – Resilient earnings, healthy capital

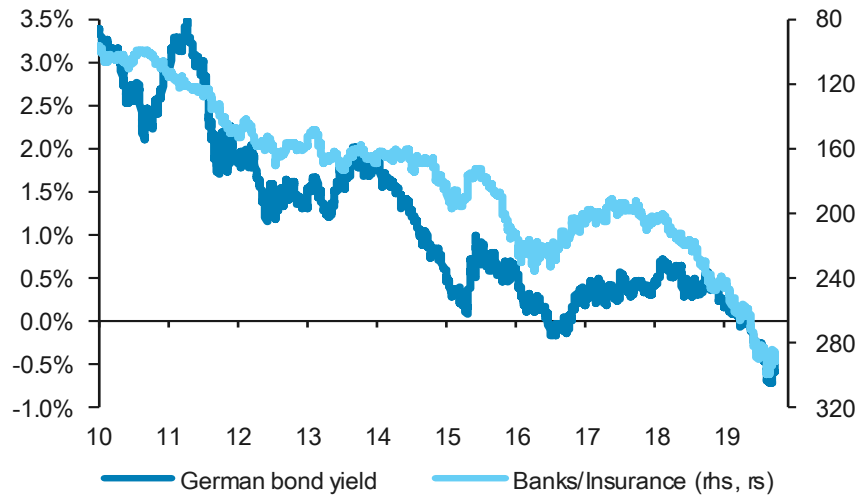
- We like Insurance due to its high dividend yield, valuation and strong EPS momentum. Our sector analysts believe that Insurers' capital position is strong, which gives them room to increase capital return to shareholders through dividends and buybacks.
- We note, however, that Insurance has already outperformed Banks a lot as it benefitted from the flight to quality and safety.
- The relative P/Book between the two is looking stretched at present, but likely reflects the lower earnings and balance sheet risk of Insurance vs Banks.
- Insurance isn't immune to lower yields.

Insurance dividend yield is backed by strong earnings



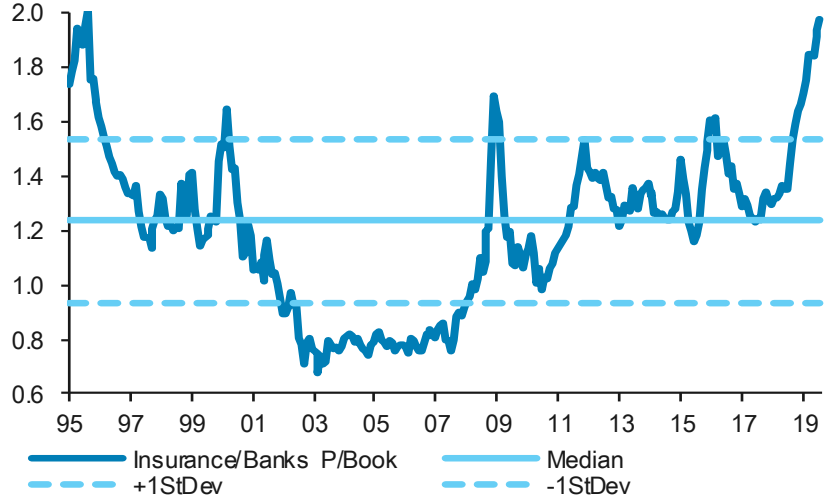
Source: IBES, Refinitiv, Barclays Research

Insurance has benefitted from the flight to quality…



Source: IBES, Refinitiv, Barclays Research

…and re-rated sharply vs Banks

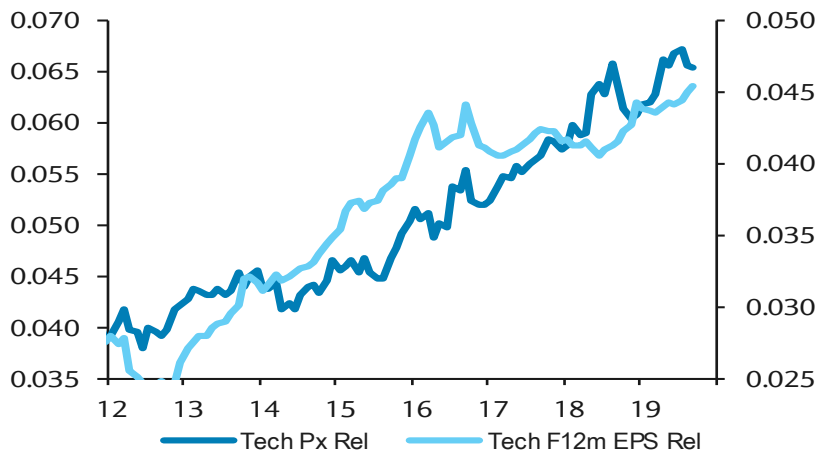


Source: IBES, Refinitiv, Barclays Research

Information Technology – Underweight

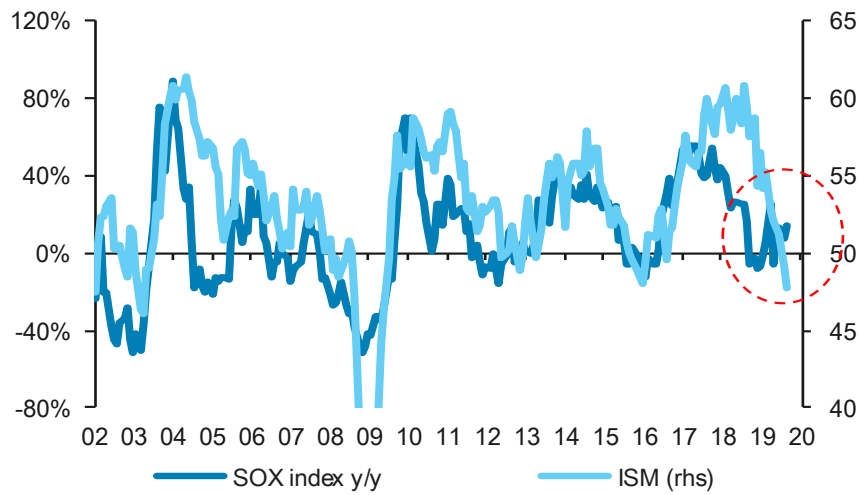
- We are UW Tech. The sector has performed well ytd but we find its valuations expensive while near-term earnings outlook is challenging.
- Tech is at the epicentre of the trade war amid national security concerns. It is likely that real disruption to global supply chains is already occurring, although the process of changing supplier base/reshoring is likely to take many years.
- The outlook for software is still constructive, as the sector is late cycle. Tech spend is rising by 6% p.a., with more share allocated to IT services. However, we find valuations quite demanding at present.

MSCI Europe Technology relative performance and earnings



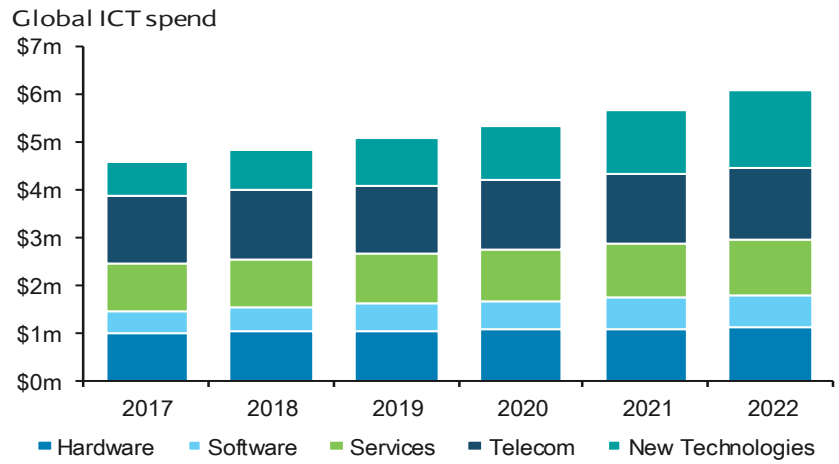
Source: MSCI, IBES, Refinitiv, Barclays Research

SOX struggling as ISM continues to fall



Source: Bloomberg

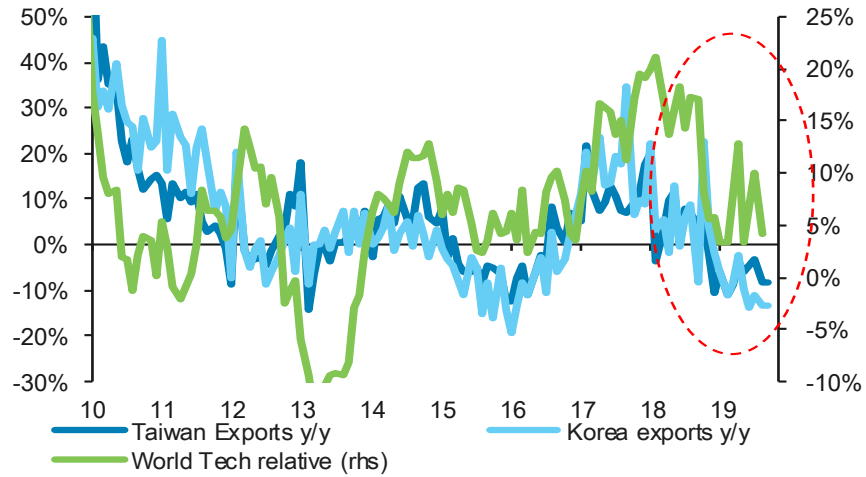
Global ICT spending is forecast to continue growing, at 6% p.a



Source: IDC figures 2017-2019. Combination of IDC and Barclays Research estimates 2020-2022

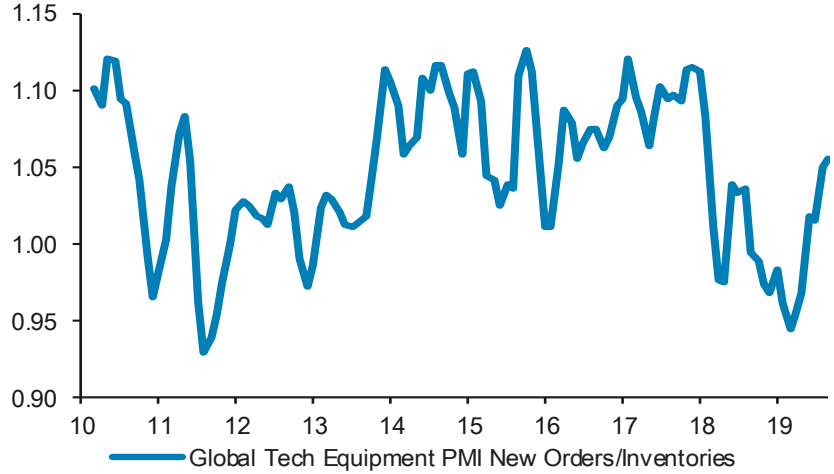
Tech indicators remain mixed

Asian tech exports remain soft



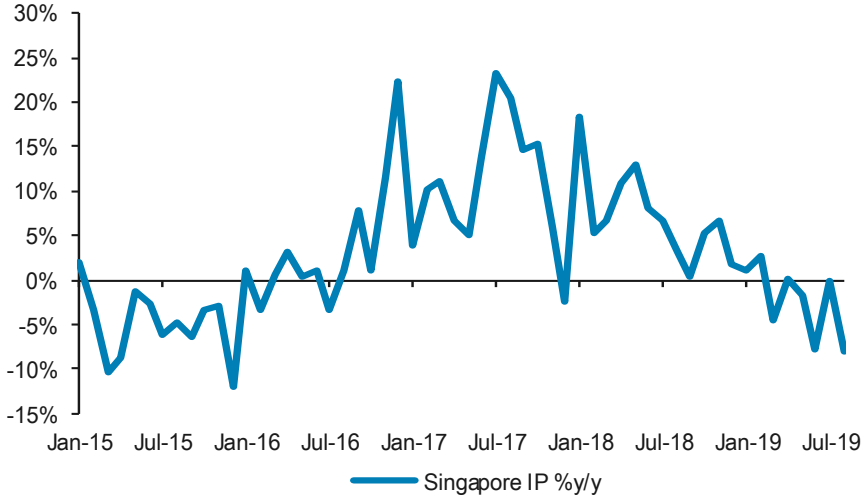
Source: Refinitiv

Tech PMI new-orders-to-inventories appears to have bottomed out



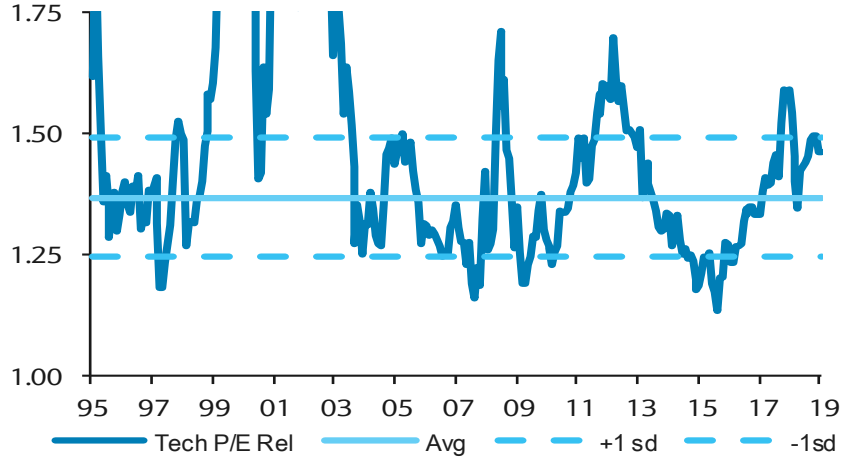
Source: Markit, Bloomberg

Singapore IP is contracting sharply



Source: Bloomberg

Tech valuations expensive again

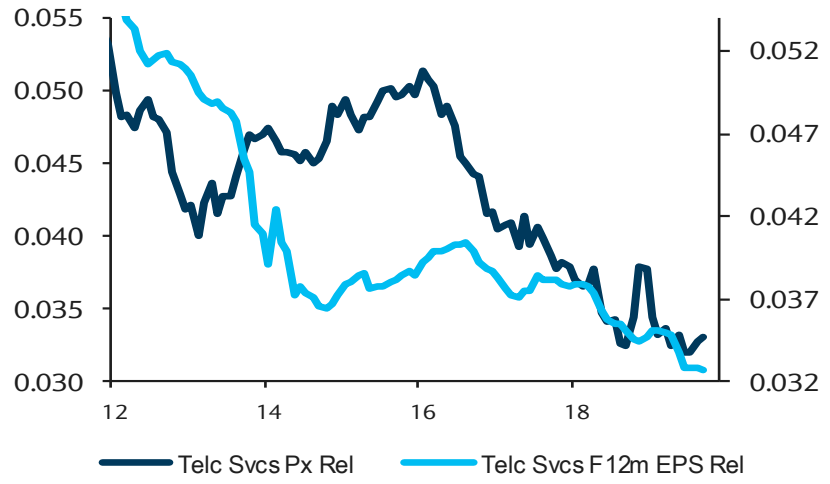


Source: MSCI, IBES, Refinitiv, Barclays Research

Telecoms – Marketweight

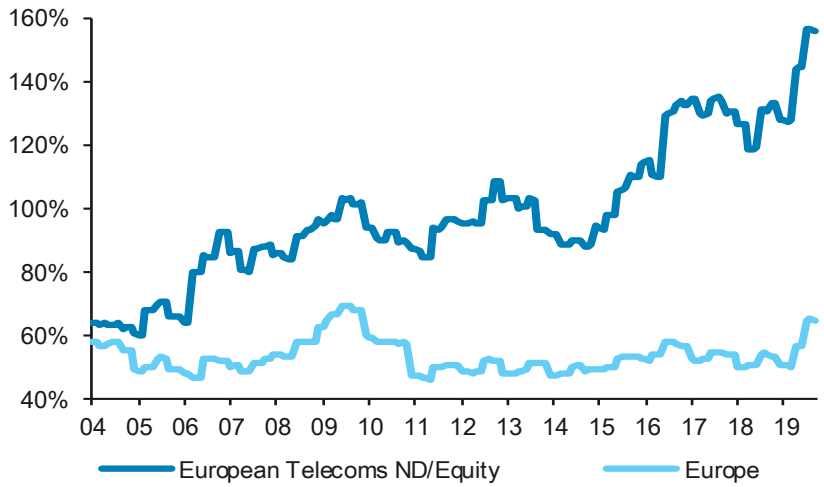
- The Telecoms sector is cheap and considered defensive.
- However it has lagged, falling substantially vs. the market despite falling bond yields.
- Clearly, the sector's fundamentals remain challenging and its relative EPS momentum remains sharply negative.

MSCI Europe Telecoms relative performance and earnings



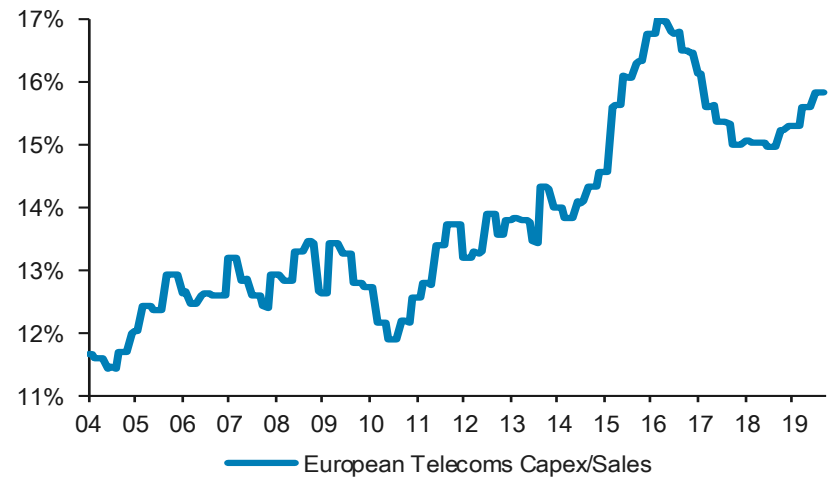
Source: MSCI, IBES, Refinitiv, Barclays Research

Telecoms balance sheet leverage has increased a lot...



Source: Worldscope, Barclays Research

...as capex requirement is not showing signs of abating

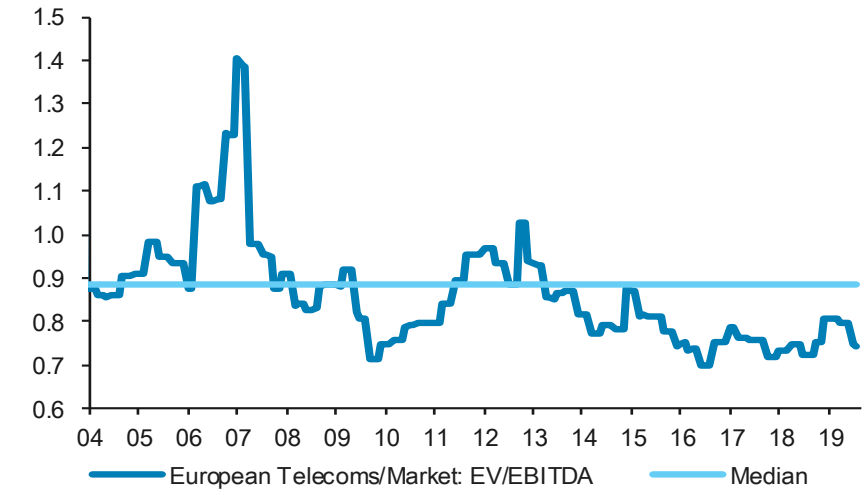


Source: Worldscope, Barclays Research

Sector looks cheap but lacks positive catalysts

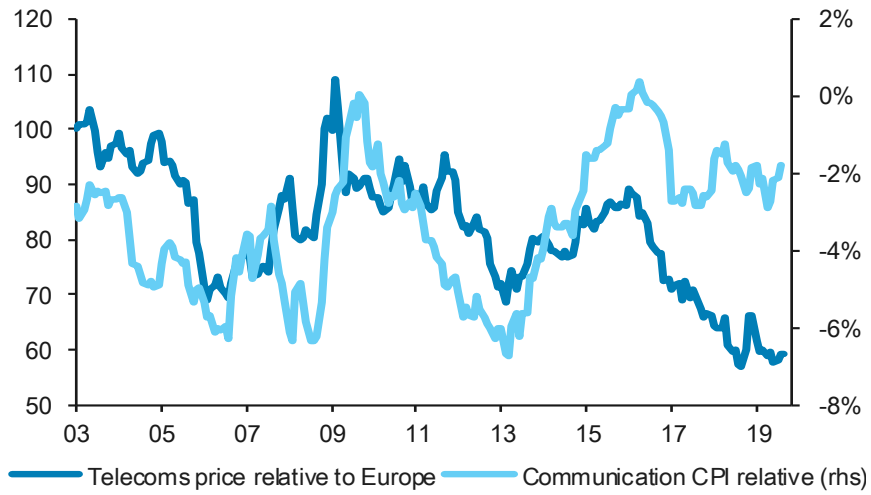
- The sector has fallen vs. the market, despite plunging bund yields. It is not behaving as a usual defensive asset.
- This is likely because pricing remains deflationary, causing a constant headwind to the sector.
- Valuation remains low relative, but it has been for many years.
- Consolidation could help with sector valuation and pricing, but we need to wait to see how the new European Commission will approach competition.

Valuations are depressed – consolidation could be a catalyst for a re-rating



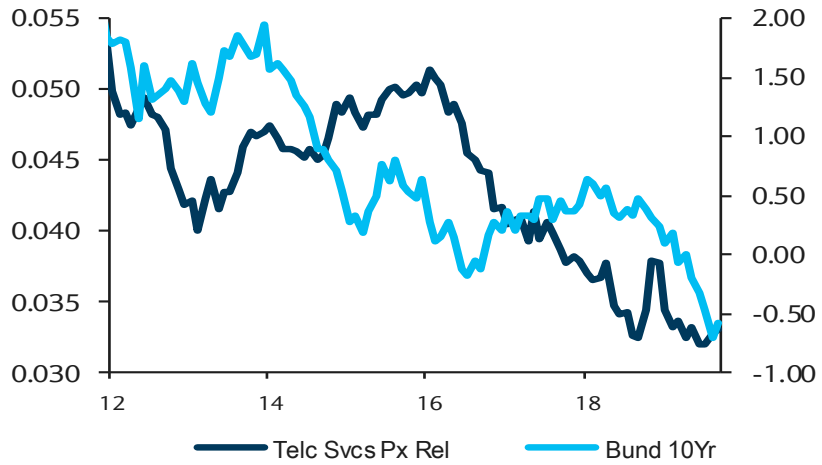
Source: Worldscope

Pricing remains weak for Telecom sector



Source: Eurostat, Refinitiv, Barclays Research

Telcos have fallen relative despite plunging bund yields

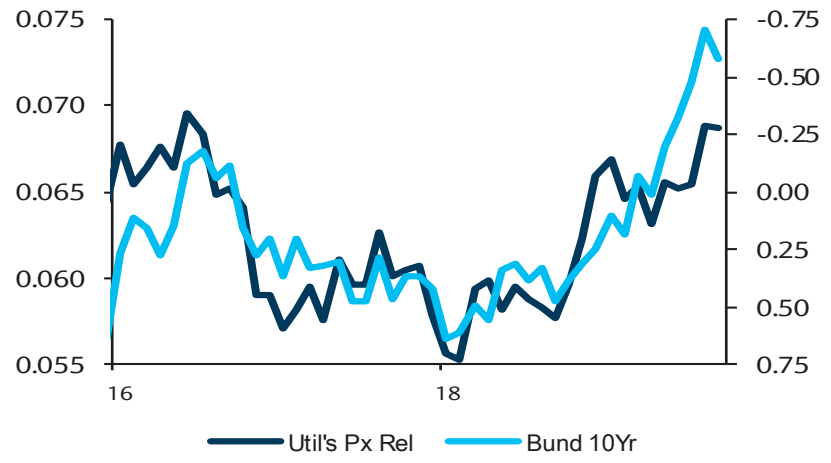


Source: EPFR, Barclays Research

Utilities – Overweight

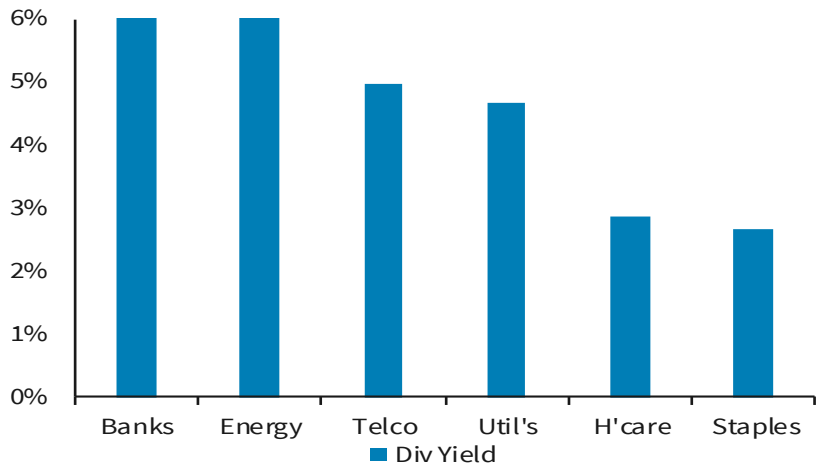
- We recently upgraded Utilities to OW (**13**) as we see continued deterioration in the global economy and want to add more defensive earnings to the portfolio.
- The sector lagged most defensives ytd and hasn't kept up with the recent fall in bond yields, although it has performed better in the last few months.
- Generally regulated and renewables doing well ytd, while the UK has underperformed given investor concerns about a change of government.
- The sector provides a resilient defensive earnings stream and also has a healthy dividend yield near 5%.

Utilities underperformed the recent bond rally



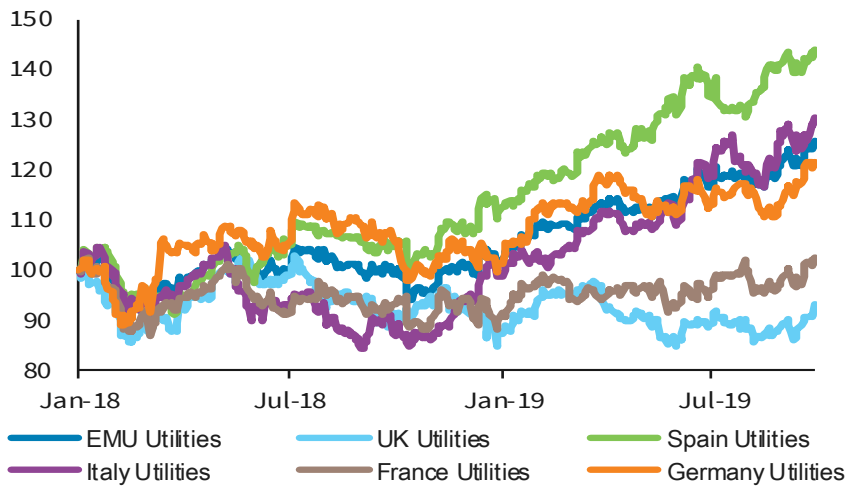
Source: IBES, MSCI, Refinitiv, Barclays Research

Dividend yield is attractive relative to other Defensives



Source: IBES, MSCI, Refinitiv, Barclays Research

Utilities held back by UK & French underperformance



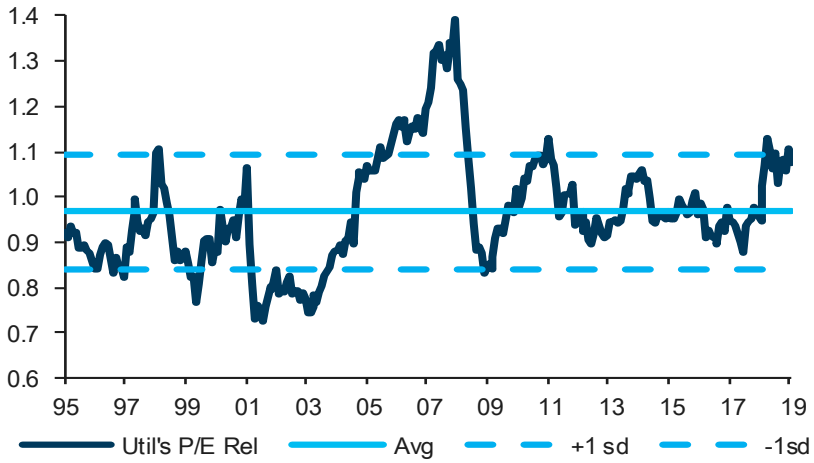
Source: IBES, MSCI, Refinitiv, Barclays Research

(13): please refer to slide 184 for hyperlinks to previously published research reports.

Valuation has risen as the sector behaved defensively

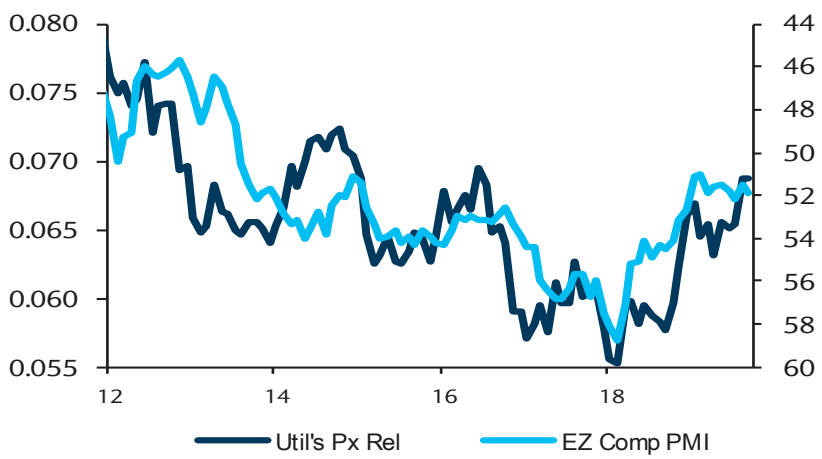
- P/E relative is near the top of the range, but it has been driven there by the sector behaving defensively.
- Renewables generation price now looks to be sustainably competitive with traditional generation.
- Renewables investment likely to take the bulk of capex from here.

P/E near top of relative range after re-rating with lower yields



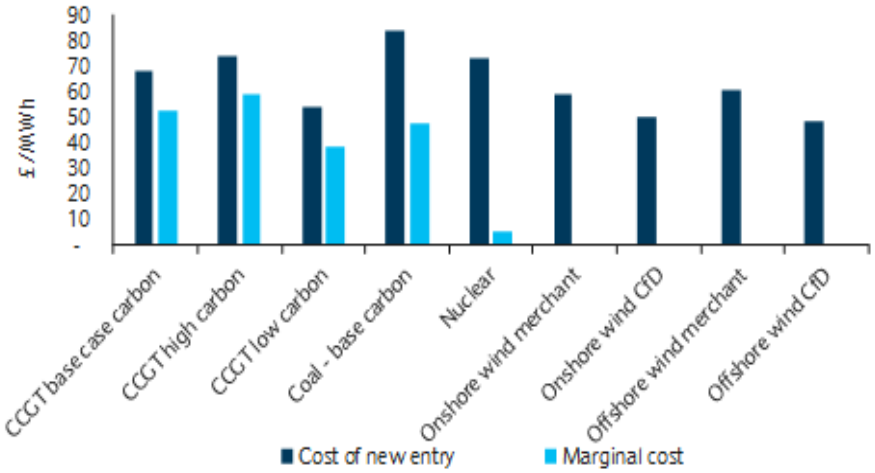
Source: IBES, MSCI, Refinitiv, Barclays Research

Utilities continues to behave like a defensive asset



Source: IBES, MSCI, Refinitiv, Barclays Research

Cost of renewables generation now at or below fossil



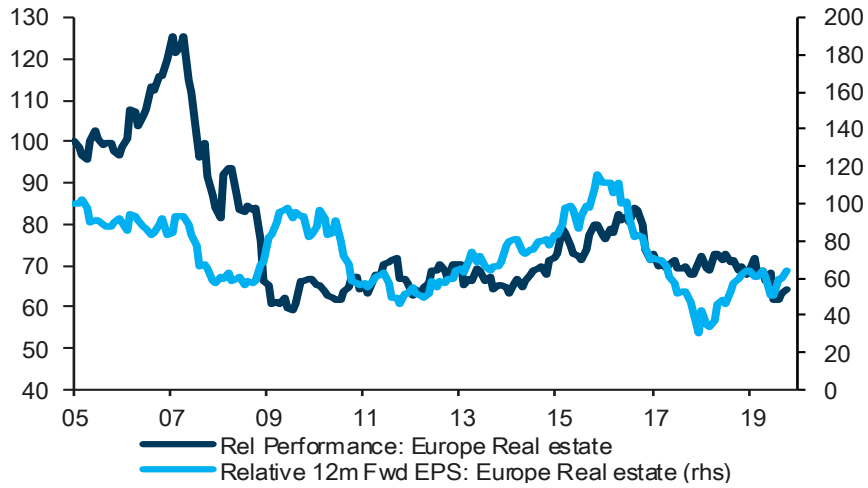
Source: IBES, MSCI, Refinitiv, Barclays Research

(13): please refer to slide 184 for hyperlinks to previously published research reports.

Real Estate – Overweight

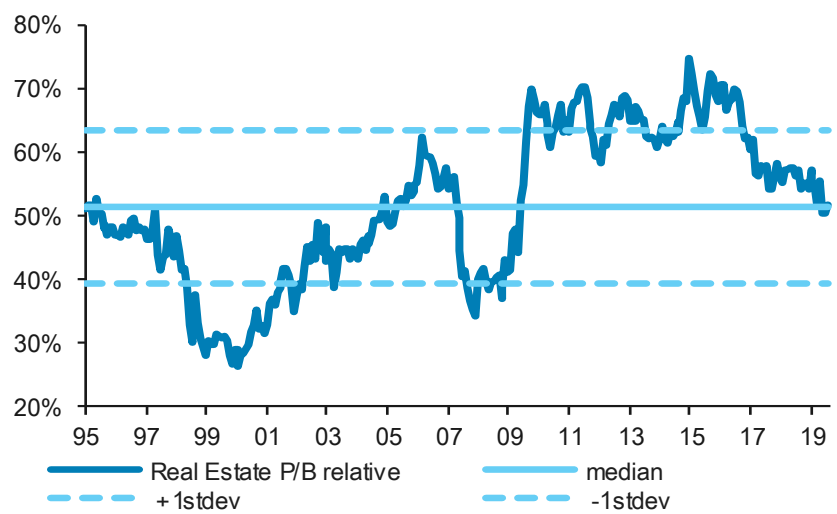
- We see Real Estate as a play on resilient domestic demand and low interest rates.
- QE has led to material increases in asset prices and reduced cost of financing, and while we expect the effects from this to be more modest going forward, we do believe that companies that see good underlying market rental growth and / or have attractive development pipelines will continue to be able to generate attractive returns going forward.
- Balance sheets are generally in good shape for most companies, with low cost of debt locked on average between 5-8 years.

Real Estate Relative Performance



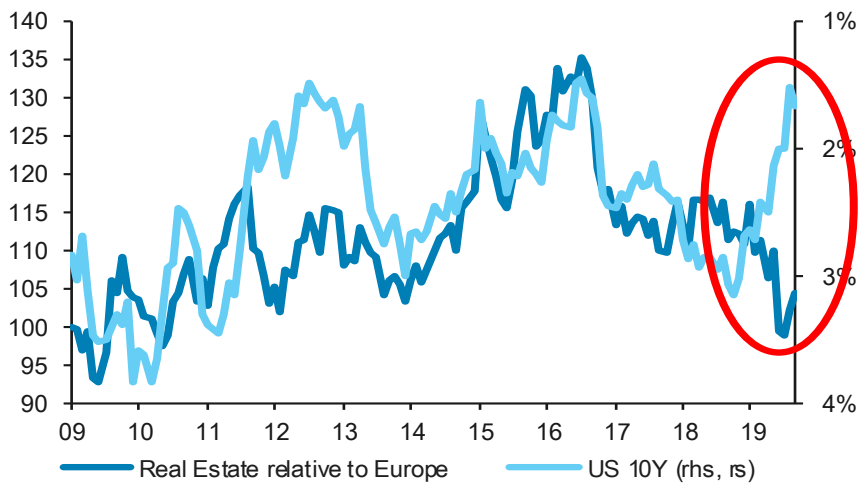
Source: MSCI, IBES, Refinitiv, Barclays Research

Real Estate valuations have improved



Source: Refinitiv, Barclays Research

Underperformance vs. bond yield continues despite small uptick



Source: Refinitiv, Barclays Research

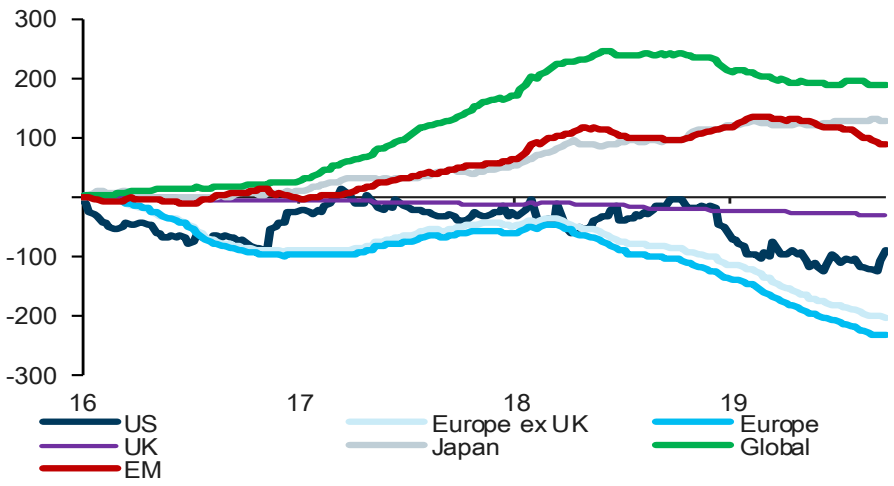
Fund Flows Snapshot

Bond and Equity flows snapshot

% of AUM	YTD	1m	3m	6m	12m
Equities	-1.6%	0.2%	-0.4%	-1.0%	-2.2%
DM	-1.5%	0.3%	-0.2%	-0.7%	-2.4%
Global	-1.1%	-0.1%	0.0%	-0.3%	-2.1%
USA	-0.5%	0.6%	0.2%	0.0%	-1.5%
Europe	-7.6%	-0.3%	-2.0%	-4.9%	-10.2%
Europe ex UK	-9.1%	-0.5%	-2.3%	-5.8%	-12.0%
UK	-2.3%	0.3%	-1.0%	-1.7%	-3.8%
Japan	1.1%	-0.3%	0.1%	1.0%	5.5%
EM	-2.3%	-0.6%	-2.2%	-3.6%	-0.5%
Active Equity	-4.7%	-0.5%	-1.5%	-3.4%	-7.8%
Passive Equity	1.9%	0.9%	0.9%	1.7%	4.1%
MM funds	8.6%	0.1%	5.3%	7.7%	11.5%
Bonds	6.2%	0.6%	2.5%	4.8%	4.5%

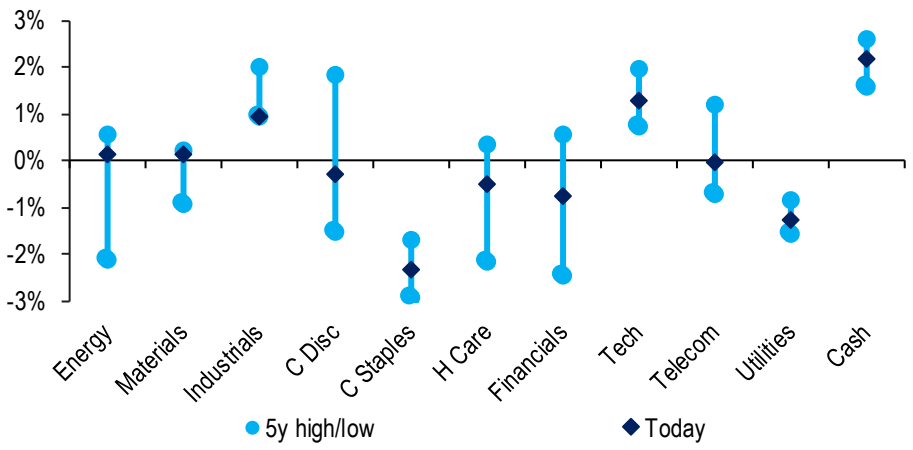
Source: EPFR

Regional cumulative equity flows since 2016 ($bn)



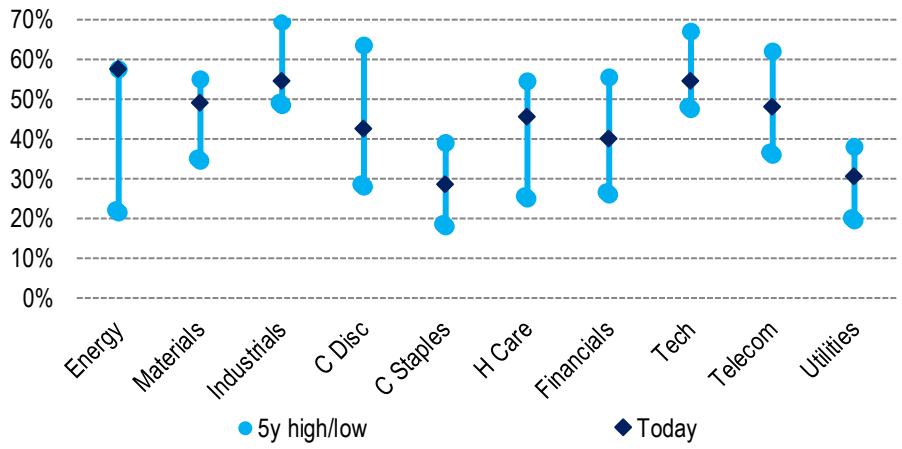
Source: EPFR

European funds' sector positioning – Fund allocation gap to benchmark



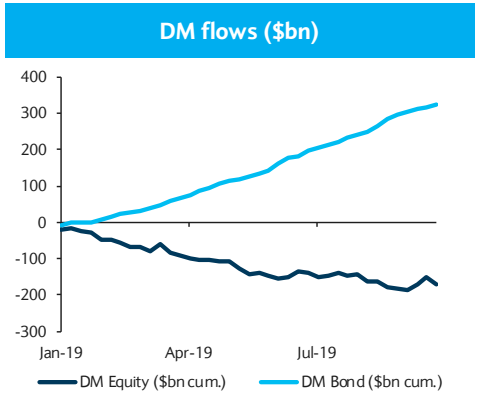
Source: EPFR, Datastream

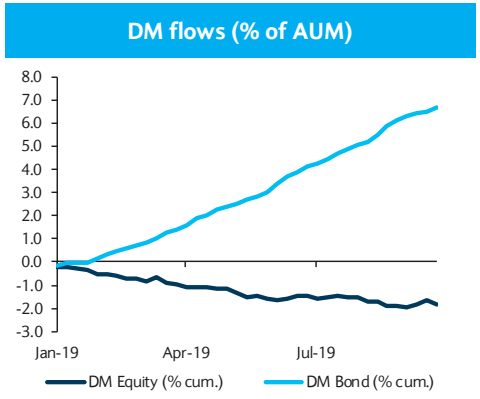
% of European funds OW per sector vs 10Y average

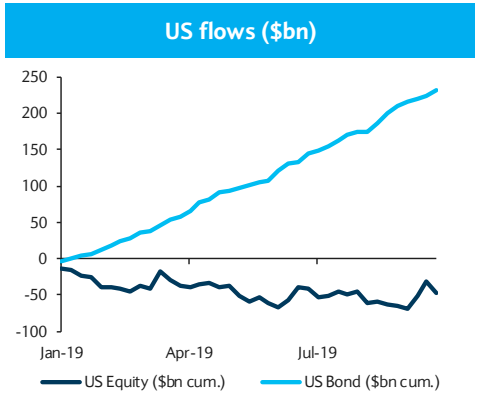


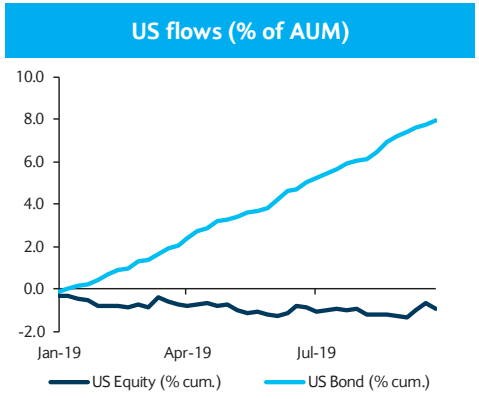
Source: EPFR, Datastream

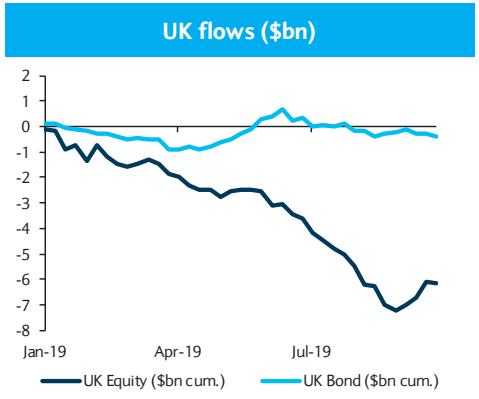
Fund Flows

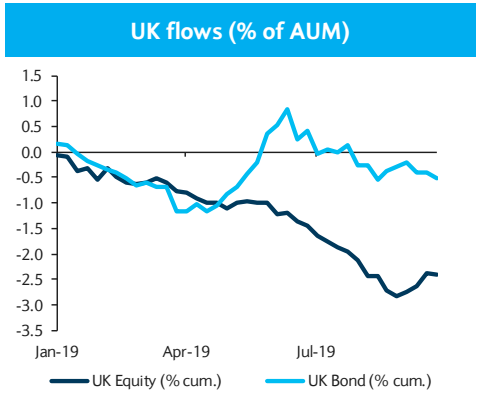


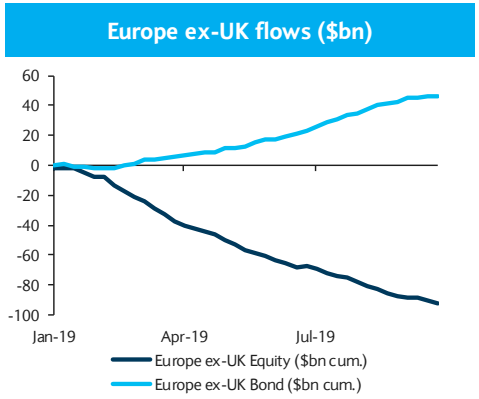


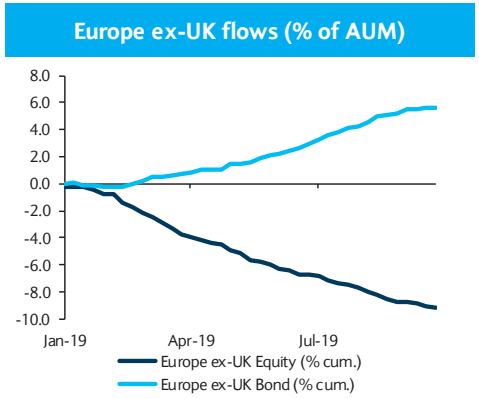


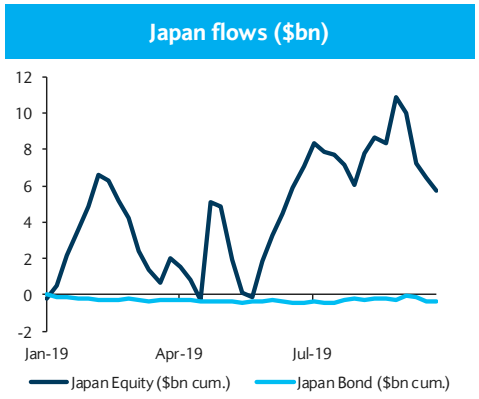


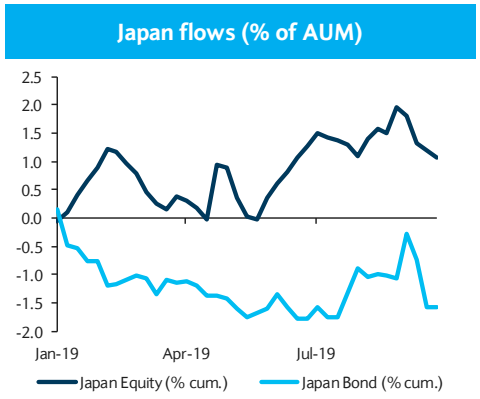


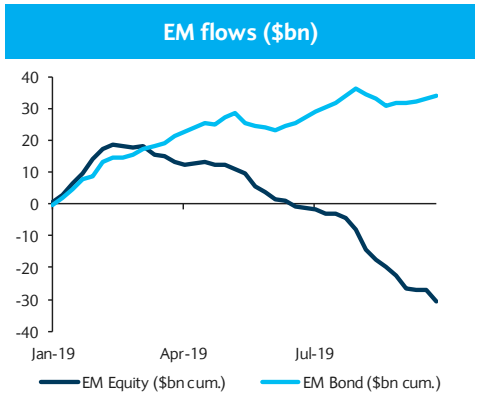


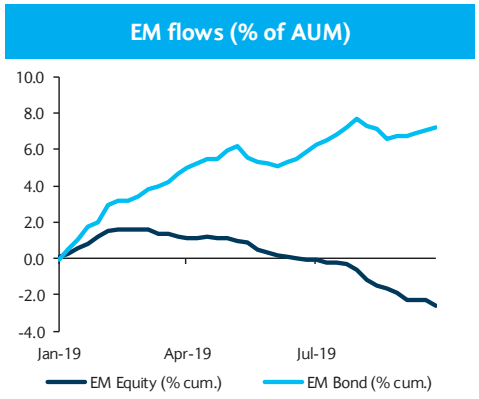










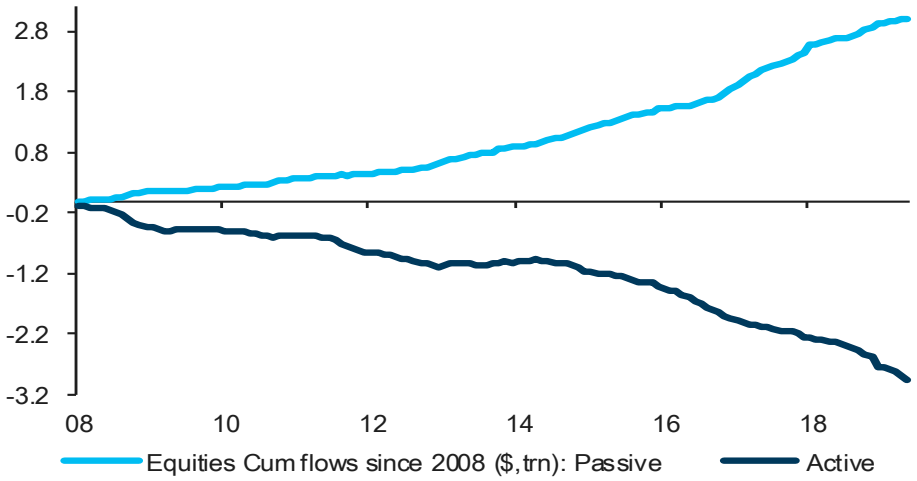


Source: Barclays Research, EPFR.

Active funds remain under pressure

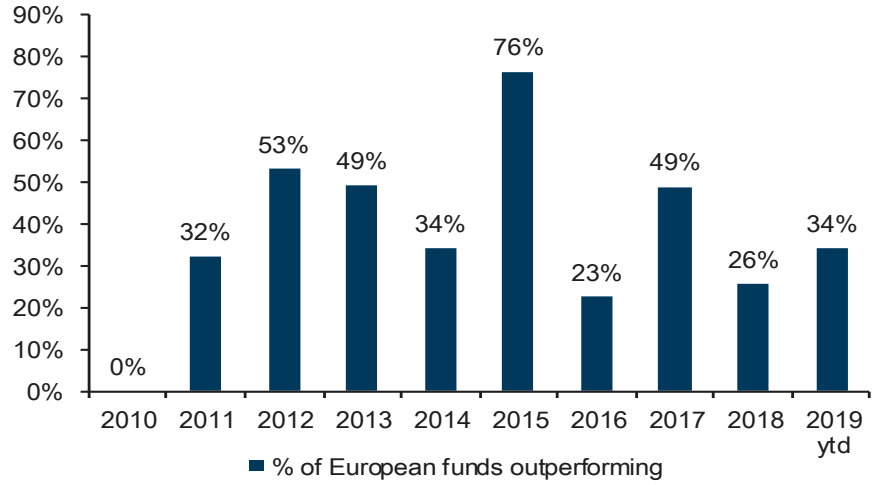
- The rise of passive investment is continuing.
- 2018 was a bad year for active managers' performance with just 26% of funds outperforming their benchmark. This year is marginally better though, with 34% of funds outperforming.

The rise of passive investment



Source: EPFR, Barclays Research

% of European funds outperforming their benchmark



Source: Bloomberg, Barclays Research

Equity Markets Snapshot

	Performance (local currency)				Performance (U$)				EPS y/y			Fwd P/E			P/Book			DY & ROE	
	-1m	-3m	-12m	Ytd	-1m	-3m	-12m	Ytd	18	19e	20e	Current	10Y Median	Current vs Median	Current	10Y Median	Current vs Median	Dividend Yield	ROE
MSCI AC World	2%	1%	0%	15%	2%	-1%	-1%	14%	13%	2%	10%	15.4	14.2	8%	2.3	2.0	11%	2.8%	13.0%
Developed	2%	1%	1%	17%	2%	0%	0%	16%	15%	2%	10%	15.9	14.8	8%	2.4	2.1	13%	2.8%	13.2%
USA	2%	1%	2%	19%	2%	1%	2%	19%	24%	2%	11%	17.4	15.6	12%	3.4	2.7	24%	2.4%	16.3%
Japan	5%	3%	-11%	7%	3%	2%	-7%	9%	-5%	-1%	6%	13.3	13.5	-1%	1.2	1.3	-5%	2.4%	9.4%
Europe	3%	2%	2%	15%	3%	-2%	-4%	11%	6%	1%	10%	13.8	13.4	3%	1.8	1.7	4%	3.7%	11.3%
Energy	5%	-5%	-12%	4%	5%	-8%	-17%	0%	39%	-8%	20%	10.5	10.6	-1%	1.2	1.3	-10%	5.9%	10.8%
Materials	3%	-4%	-6%	11%	3%	-8%	-11%	6%	6%	-13%	9%	13.4	13.3	0%	1.7	1.8	-4%	3.8%	11.8%
Industrials	3%	1%	3%	21%	2%	-3%	-3%	16%	4%	8%	10%	16.3	15.0	9%	3.2	2.7	19%	2.7%	16.1%
C Discretionary	3%	1%	2%	20%	2%	-3%	-4%	14%	-1%	-3%	13%	13.1	12.7	3%	1.9	2.1	-10%	3.0%	13.4%
C Staples	-1%	5%	13%	23%	-1%	1%	8%	18%	7%	9%	8%	18.8	17.7	6%	3.5	3.3	6%	2.6%	16.0%
Healthcare	1%	5%	10%	18%	1%	1%	5%	15%	4%	3%	9%	16.0	15.2	5%	3.9	3.6	8%	3.0%	19.6%
Financials	8%	0%	-7%	8%	7%	-4%	-12%	4%	8%	2%	5%	9.6	10.4	-8%	0.8	0.9	-12%	5.3%	8.0%
Technology	3%	0%	5%	25%	2%	-4%	-1%	19%	4%	8%	20%	20.1	18.2	11%	3.9	3.2	22%	1.5%	11.2%
Telecom	3%	4%	6%	3%	3%	0%	0%	-1%	-11%	2%	9%	13.8	13.4	3%	1.7	1.6	4%	4.6%	9.7%
Utilities	4%	8%	23%	21%	3%	4%	15%	16%	-6%	7%	9%	14.8	13.2	12%	1.8	1.5	23%	4.5%	11.3%
Real Estate	5%	7%	-4%	9%	5%	3%	-10%	4%	6%	3%	3%	16.4	18.5	-11%	0.9	1.0	-11%	4.7%	5.8%
UK	3%	-1%	-2%	9%	4%	-4%	-8%	6%	11%	-1%	8%	12.2	12.5	-2%	1.7	1.8	-7%	4.6%	12.5%
Eurozone	4%	2%	2%	17%	3%	-2%	-5%	11%	3%	1%	11%	13.4	13.0	4%	1.6	1.5	6%	3.4%	9.9%
Germany	3%	0%	-3%	12%	2%	-4%	-9%	7%	-6%	-3%	14%	13.1	12.3	6%	1.5	1.6	-2%	3.2%	8.9%
France	3%	3%	2%	19%	2%	-2%	-4%	13%	8%	1%	11%	14.0	13.2	6%	1.7	1.4	15%	3.3%	10.3%
Spain	5%	0%	0%	9%	4%	-4%	-6%	4%	8%	2%	7%	11.2	11.7	-4%	1.2	1.3	-12%	4.5%	9.6%
Italy	4%	4%	7%	20%	3%	-1%	0%	14%	19%	5%	7%	11.0	11.4	-4%	1.2	1.0	18%	4.5%	9.7%
Netherlands	4%	6%	13%	26%	3%	2%	7%	20%	7%	3%	10%	16.2	14.2	14%	2.3	1.9	17%	2.7%	12.1%
Switzerland	1%	2%	12%	22%	1%	0%	10%	20%	10%	8%	9%	17.4	15.8	10%	3.0	2.5	18%	2.9%	14.2%
Sweden	4%	1%	-1%	16%	4%	-5%	-11%	4%	-2%	6%	5%	15.0	15.0	0%	2.0	2.1	-4%	4.1%	13.3%
Denmark	0%	3%	7%	17%	-1%	-1%	1%	12%	-4%	-2%	14%	19.9	16.9	18%	4.1	3.2	26%	2.3%	18.6%
Norway	3%	3%	-6%	8%	4%	-4%	-16%	3%	6%	-3%	16%	13.3	11.6	15%	1.8	1.6	14%	4.5%	12.7%
Canada	2%	1%	3%	16%	2%	0%	0%	19%	11%	7%	7%	14.1	14.3	-1%	1.8	1.9	-3%	3.2%	11.7%
Australia	2%	1%	8%	18%	2%	-3%	1%	13%	1%	5%	1%	16.5	14.5	14%	2.1	2.0	6%	4.2%	12.0%
EM	1%	-3%	-3%	5%	2%	-5%	-4%	4%	8%	2%	13%	12.0	11.1	8%	1.6	1.6	-2%	3.1%	11.9%
Brazil	3%	3%	27%	16%	2%	-5%	22%	8%	15%	23%	9%	12.3	10.6	16%	2.1	1.5	35%	3.0%	15.7%
Mexico	1%	0%	-13%	3%	3%	-2%	-17%	3%	-1%	12%	11%	13.5	16.4	-18%	2.0	2.7	-27%	3.0%	13.3%
Chile	5%	-1%	-10%	-6%	4%	-7%	-19%	-11%	17%	-18%	17%	16.2	15.4	6%	1.6	1.9	-17%	3.5%	10.8%
Russia	0%	-2%	10%	16%	3%	-4%	11%	23%	63%	-11%	5%	5.6	5.3	7%	0.9	0.8	9%	7.4%	17.3%
India	2%	-3%	1%	3%	3%	-6%	3%	1%	3%	24%	20%	17.3	16.5	5%	2.6	3.1	-16%	1.5%	11.3%
China	0%	-5%	-6%	6%	0%	-5%	-6%	5%	8%	20%	13%	11.3	10.5	7%	1.6	1.7	-1%	2.8%	12.5%
Taiwan	3%	3%	-2%	13%	4%	3%	-3%	12%	-5%	-7%	12%	15.3	13.5	14%	1.8	1.9	-3%	4.0%	11.3%
Korea	6%	-1%	-9%	6%	7%	-5%	-16%	-2%	-1%	-30%	23%	11.1	9.4	19%	0.9	1.1	-22%	2.5%	8.4%
South Africa	-2%	-7%	-2%	0%	-2%	-13%	-9%	-5%	2%	18%	14%	12.3	13.6	-10%	2.1	2.4	-15%	3.3%	12.1%
Turkey	9%	9%	6%	15%	12%	12%	13%	8%	24%	-9%	36%	6.1	9.0	-32%	1.1	1.5	-28%	3.7%	14.4%

Source: Datastream, IBES, Barclays Research, as of Sep 30, 2019

European Index year-end targets

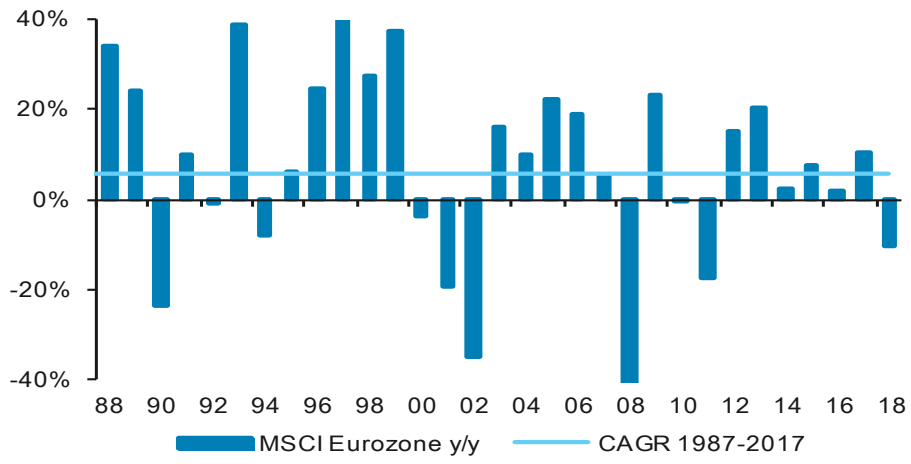
- We set our index targets using our earnings growth and P/E forecast models. These use as inputs the house views on growth, inflation, FX rates, bond yields, and commodity prices.
- The single-digit upside to our price targets is a combination of low single-digit earnings growth, and a small amount of P/E expansion, as we believe P/Es have contracted too far given the slowing-but-still-resilient growth environment we expect over the coming year.

Barclays' Dec-19 Index targets

	FTSE 100	SXXE	SXXP
IBES 19e EPS growth	-1%	2%	2%
Barclays 19e EPS growth	1%	2%	2%
Barclays 20e EPS growth	5%	5%	4%
IBES Dec 19e P/E	12.988	14.9	15.0
Current Price	7,408	384	393
Barclays Dec 19e Target	7100	360	370
%Up/downside	-4%	-6%	-6%

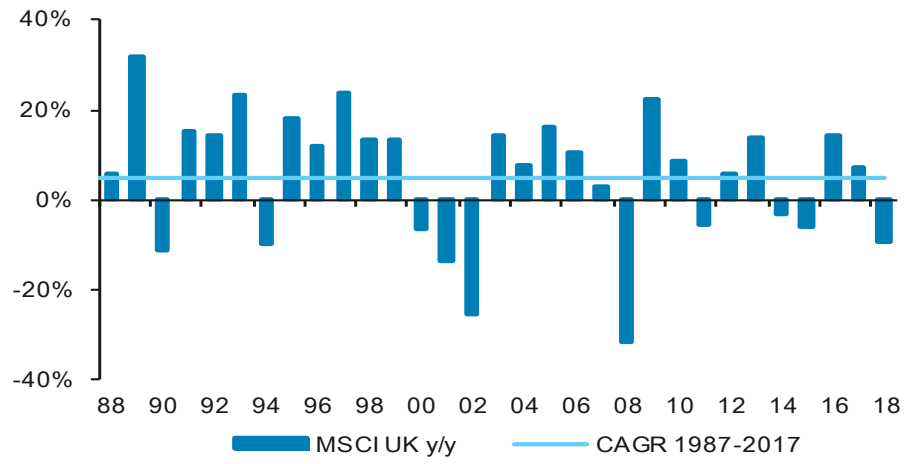
Source: Barclays Research, Bloomberg. Current price as at market close on Sep 30, 2019

MSCI Eurozone long-term CAGR is 6%



Source: Datastream

MSCI UK long-term CAGR is 5%



Source: Datastream

Referenced Research

- 1) Turning more defensive - August Chart Pack (6th August 2019)
- 2) Reducing beta exposure - May Chart Pack (8th May 2019)
- 3) Turning more defensive - August Chart Pack (6th August 2019)
- 4) Fiscal easing on its way, but lower-for-longer yields to constrain the broader risk-on trade (25th March 2019)
- 5) Don't sell the rally, yet - April Chart Pack (3rd April 2019)
- 6) 2019 Outlook - Late Cycle Blues (28th Nov 2018)
- 7) Reducing beta exposure - May Chart Pack (8th May 2019)
- 8) 2019 Outlook - Late Cycle Blues (28th Nov 2018)
- 9) Turning more defensive - August Chart Pack (6th August 2019)
- 10) Turning more defensive - August Chart Pack (6th August 2019)
- 11) Turning more defensive - August Chart Pack (6th August 2019)
- 12) Reducing beta exposure - May Chart Pack (8th May 2019)
- 13) Turning more defensive - August Chart Pack (6th August 2019)

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