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As We See It

Welcome to the latest edition of *As We See It*.

Over the next few months, we will refine and reshape the content of this publication to meet the needs of its readership. Any comments and suggestions would, as always, be much appreciated.

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Our views summarised

Markets

- There are signs of worry in the financial markets. This is cause for concern, as fear can become a self-fulfilling prophecy.
- Data this week has not been encouraging, despite a month-on-month rise in US housing starts. Building permits are still falling and inventories of unsold homes are still sky-high. The housing market recession is likely to continue well into next year.
- The market's inflation expectations have risen recently, while growth expectations have fallen, raising the spectre of stagflation. As a result, inflation is now key; any sign of rising prices could provoke a self-fulfilling sell-off, while the opposite would help riskier assets like equities recover.

Fixed income

- Corporate bond yields have continued to widen recently, as concerns about liquidity have again come to the fore.
- Ratings agency Standard and Poor's (S&P) held a timely conference on the European banking sector this week. S&P expects UK bank ratings to remain stable, but European banking earnings are likely to fall sharply.
- Almost ten years after the LTCM debacle, S&P believes that losses from the recent credit crisis have been contained. However, the agency cautioned that risk management practices have been outpaced by product development, and will need careful monitoring.

FX

- The dollar has dropped further against sterling, yen and the euro, on news that Gulf nations may diversify their currency reserves. The dollar hit new record lows against the euro on increased global growth concerns.
- The currencies we expect to benefit from a move away from the dollar are, among others, the euro, sterling and Norwegian krone, which could be used as key currencies in a new pegged basket.
- We also focus on the Canadian dollar, which is beginning to stabilise, though it will remain supported by high energy prices and a solid domestic economy in the medium term.

Equities

- This week, we have added Morrisons and Carphone Warehouse to the UK Buy list.
- In the Focus List portfolio, we have reduced our position in Tesco (which has strongly outperformed the sector, and is now trading close to our fair value) in order to go overweight in Morrisons. We have reduced our position in Experian, which we recently downgraded, to take a position in Carphone Warehouse.
- The Focus List has fractionally outperformed the FTSE 350 this week, helped largely by a strong showing from Britvic.

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Signs of worry in the financial markets are cause for concern, as fear can become a self-fulfilling prophecy

Data this week has not been encouraging, and the housing market recession is likely to continue well into next year

Inflation expectations have risen recently, while growth expectations have fallen, raising the spectre of stagflation

This means that inflation is now key; any indication of rising prices is likely to depress riskier assets like equities

Nothing to fear but fear itself?

Sometimes, the most frightening thing is fear itself. In the financial markets, there have been enough signs of worry in recent weeks to make one distinctly nervous. Such fear could signal a real underlying problem. Even if it does not, fear can become a self-fulfilling prophecy.

Fear in the markets can have both simple and complex knock-on effects. Perhaps the most direct link is between the equity markets and economic growth; when markets are confident, rising equity prices cause higher optimism and higher consumption at both the corporate and, more importantly, consumer level. Recently, surging fear of a hard landing in the US and a collapse of part of the financial system has caused sharp corrections in riskier asset classes. Consequently, dropping equity prices and falling bond yields have gone hand-in-hand with large cuts in growth expectations.

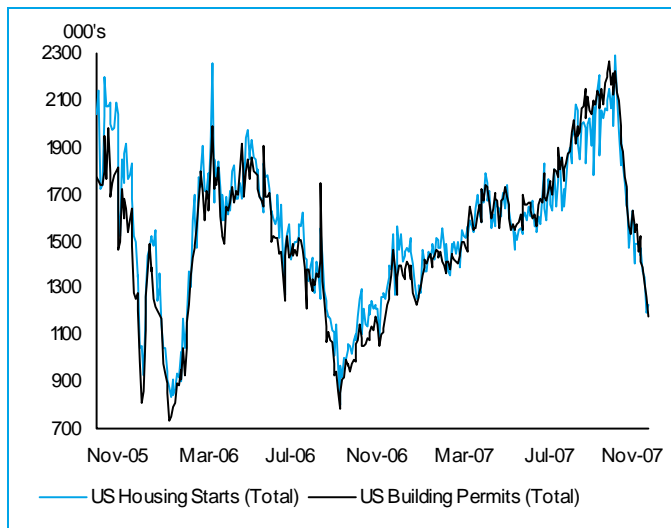
While this has been a relatively light week for data, the results we have had did not help brighten the picture. Anyone encouraged by the month-on-month increase in US housing starts should look at Figure 1. We have had these ticks on the graph on the way down before, and none have been significant. Building permits are still falling, inventories of unsold homes are still sky-high and the nonconforming part of the lending market remains either under pressure (jumbo loans) or closed (sub-prime). The housing market recession has been with us for some time, and is expected to continue well into next year.

This is a problem in itself, but even more troubling for markets is the fact that US inflation expectations – as measured by breakevens in 5 and 10-year bonds, shown in Figure 2 – have actually increased over recent months. Given that growth expectations have fallen over the same period, the only explanation is that the market is pricing in an increasing probability of stagflation.

As we have said many times, stagflation is one of the worst prospects for financial markets. An absence of growth – or recession – plus inflation accelerating out of control is a lethal cocktail. Past stagflation episodes have shown that while equities are theoretically (and perhaps truly) a hedge against inflation in the long term, this is far from true in the short to medium term. Over shorter horizons, equities tend to be punished hard by the increase in volatility and the lack of central bank flexibility that rising inflation causes.

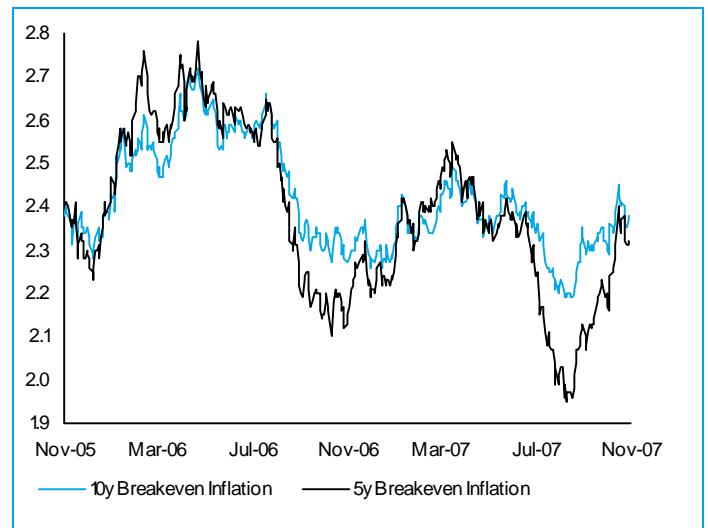
As a result, inflation is now once again key to the future of the markets. Rising prices could provoke a self-fulfilling panic, driving riskier assets like equities down further and halting the recovery in bonds. However, if (as we expect) inflation remains under control, there is a good chance that the market will start to price in more confidence and riskier asset classes will rebound.

Figure 1 – US monthly housing starts and building permits



Source: Barclays Wealth Research

Figure 2 – Inflation breakevens, 5- and 10-year US bonds



Source: Barclays Wealth Research

The week ahead

A very busy week for data in the US next week, but a quieter one for Europe.

In the US, on Tuesday we get further insight into the main areas of concern for the US economy (housing and the consumer) with the release of the closely followed Case-Shiller house price index and consumer confidence data. Wednesday sees the release of data on durable goods orders and mortgage approvals. On Thursday, we get further housing market news with the latest new home sales data, while Friday brings the Chicago PMI.

In Europe, the German Ifo index is released on Tuesday, and on Wednesday we get the closely-followed M3 money supply data. In the UK, the latest house price index from the Nationwide is due on Thursday.

Economic diary

DATE	AREA	TIME (BST)	ECONOMIC DATA	PREVIOUS	MEDIAN*
26/11/07	Japan	23.50	Corporate service prices (year) – Oct	1.4%	1.5%
27/11/07	Germany	09.00	Ifo business climate (index) – Nov	103.9	103.5
	Germany	09.00	Ifo business climate (current conditions) – Nov	109.6	109.4
	Germany	09.00	Ifo business climate (business expectations) – Nov	98.6	98.1
	US	15.00	Consumer confidence (index) – Nov	95.6	91.0
	Japan	23.50	Retail sales (year, large stores) – Oct	-2.0%	-1.1%
	Japan	23.50	Retail sales (year, retail trade) – Oct	0.5%	0.7%
28/11/07	Germany	07.10	Gfk consumer confidence survey (index) – Dec	4.9	4.3
	EMU	09.00	M3 (year, M3) – Oct	11.3%	11.6%
	EMU	09.00	M3 (year, private sector loans) – Oct	11.0%	-
	US	13.30	Durable goods orders (month)	-1.7%	0.0%
	US	13.30	Durable goods orders (ex-transportation) – Oct	0.3%	0.4%
	US	15.00	Existing home sales (millions, month) – Oct	5.04	5.00
	US	19.00	Federal reserve's beige book – Oct	-	-
	Japan	23.50	Industrial production (month) – Oct	-1.4%	1.5%
	Japan	23.50	Industrial production (year) – Oct	0.8%	4.4%
29/11/07	UK	07.00	Nationwide house prices (month) – Nov	1.1%	-
	UK	07.00	Nationwide house prices (year) – Nov	9.7%	-
	UK	09.30	Consumer credit and mortgages (consumer credit, £bn) – Oct	1.4	1.2
	UK	09.30	Consumer credit and mortgages (new mortgages, 000's) – Oct	102	97
	Germany	08.55	Unemployment (change, sa) – Nov	-40,000	-30,000
	Germany	08.55	Unemployment (change, nsa) – Nov	-110,000	-
	Germany	08.55	Unemployment (rate, sa) – Nov	8.7%	8.7%
	US	13.30	GDP (quarter annualised) – Q3	3.9%	4.8%
	US	13.30	GDP (price deflator) – Q3	0.8%	0.8%
	US	13.30	Initial jobless claims (000's, month) – Nov	330	330
	US	15.00	New home sales (000's, month) – Oct	770	750
	US	15.00	OFHEO house price index (quarter) – Q3	0.1%	-
	US	15.00	OFHEO house price index (year) – Q3	3.2%	-
	Japan	23.30	CPI (Tokyo, total, month) – Nov	0.0%	-
	Japan	23.30	CPI (Tokyo, total, year) – Nov	0.1%	0.3%
	Japan	23.30	CPI (Tokyo, core, month) – Nov	0.2%	-
	Japan	23.30	CPI (Tokyo, core, year) – Nov	0.0%	0.1%
	Japan	23.30	CPI (all Japan, total, month) – Sep	-0.2%	-
	Japan	23.30	CPI (all Japan, total, year) – Sep	-0.2%	0.1%
	Japan	23.30	CPI (all Japan, core, month) – Sep	-0.1%	-
	Japan	23.30	CPI (all Japan, core, year) – Sep	-0.1%	0.0%
	Japan	23.30	Unemployment (rate, sa) – Oct	4.0%	4.0%
	Japan	23.30	Unemployment (job offers to applicants ratio) – Oct	1.05	1.05
	Japan	23.30	Household spending (national expenditures) – Oct	3.0%	-
	Japan	23.30	Household spending (real expenditures) – Oct	3.2%	0.5%
30/11/07	Japan	05.00	Housing starts (year) – Oct	-44.0%	-36.7%

DATE	AREA	TIME (BST)	ECONOMIC DATA	PREVIOUS	MEDIAN*
	Japan	05.00	Construction orders (year) – Oct	-16.3%	-
	EMU	10.00	GDP (quarter) Q3	0.7%	0.7%
	EMU	10.00	GDP (year) Q3	2.6%	2.6%
	UK	10.30	Gfk consumer confidence (balance) – Nov	-8	-
	US	13.30	Personal income and spending (personal income) – Oct	0.4%	0.4%
	US	13.30	Personal income and spending (personal spending) – Oct	0.3%	0.3%
	US	13.30	Personal income and spending (core PCE deflator, month) – Oct	0.2%	0.2%
	US	13.30	Personal income and spending (core PCE deflator, year) – Oct	1.8%	1.8%
	US	14.45	Chicago PMI (index) – Nov	49.7	50.2
	US	15.00	Construction spending (millions, month) – Oct	0.3%	-0.3%

*Average forecast of a survey of professional forecasters

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Corporate bond yields continue to widen, as concerns about liquidity again come to the fore

S&P expects UK bank ratings to remain stable, but European banking earnings are likely to fall sharply

The leveraged loan market should clear slowly in 2008, but is likely to remain subdued

More liquidity worries, but S&P looks to the future

Corporate bond yields have continued to widen, as shown in Figure 1, as concerns over liquidity have resurfaced. These fears are well-founded: liquidity is indeed dwindling as brokers close their fourth-quarter reporting period. The spread between US three-month Treasury bills and three-month LIBOR, shown in Figure 2, continued to widen, indicating very low liquidity. This situation could continue throughout December. We therefore maintain our defensive stance by recommending the highest part of the rating spectrum.

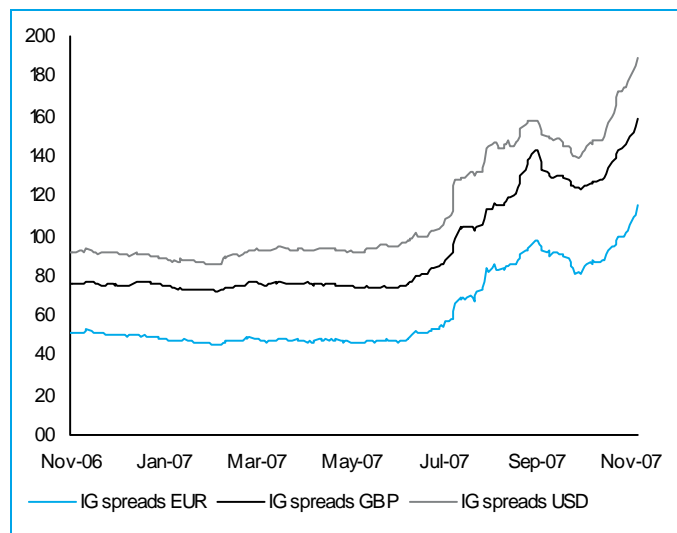
This week, ratings agency Standard and Poor's (S&P) held a very timely conference on the European banking sector. This included presentations on the current market turbulence and reflections on the impact of recent events in the leveraged loan and asset-backed commercial paper (ABCP) markets on the European banking system.

In the UK, ratings are expected to remain stable, but S&P acknowledges that banks with the highest dependence on the wholesale and RMBS markets could come under pressure if the liquidity situation deteriorates. On the European banking outlook, unsurprisingly, S&P expects earnings to decline sharply and anticipates a renewed emphasis on cost management. S&P also spoke about the liquidity situation of the European banks and highlighted the current fragility of the ABCP market. Overall, we have already seen a very significant decline in US ABCP outstanding, which stood at roughly \$1.2 trillion in August, but only around \$850 billion now. Clearly, the market has shrunk massively.

The structured investment vehicle (SIV) market is itself very much in wind-down mode too, with only \$289 billion outstanding at the end of October, compared with more than \$400 billion at the end of March 2007. S&P believes that these vehicles are no longer providing a funding advantage and expects an impact on banks' revenues, as swap desk revenue and fee income capital decline. However, S&P thinks that European banks' exposures to ABCP and SIV markets should remain manageable.

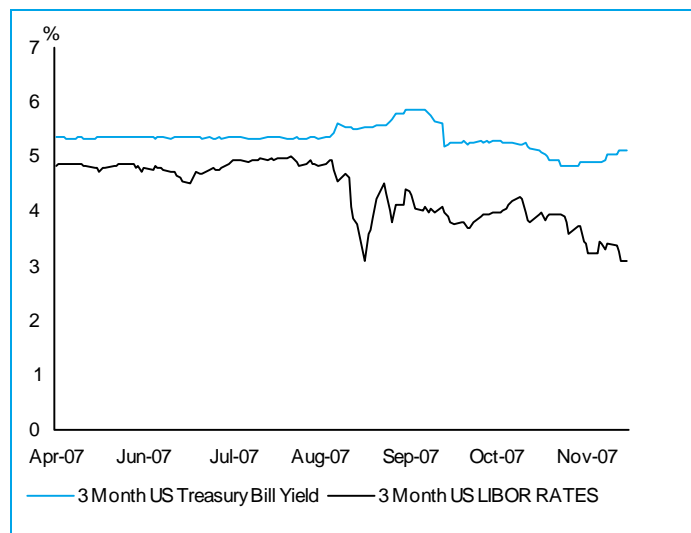
On the leveraged loan market, the agency reviewed the reasons for this sector's reversal of fortune, following tremendous growth since 2004. The agency stressed that cov-lite structures initially came under threat in the summer, and that the spill-over from the sub-prime market drove the rest of the correction. However, the leveraged loan market's pipeline is now slowly clearing, although banking revenues from this kind of activity are likely to remain extremely subdued. S&P believes that we could see additional write-downs in the near future, but believes that most of the pricing problems should be addressed. It expects the leveraged loan pipeline to clear slowly in 2008, and sees the reduced risk profile of leveraged finance operations as positive for the banking sector.

Figure 1 – IG corporate bond spreads



Source: MLX

Figure 2 – Spread between US three-month treasury bills and three-month LIBOR



Source: Bloomberg

S&P believe losses have been contained, but that product development has outpaced risk management in recent years

On the risk management side, S&P said that robust practices had certainly helped banks, and appeared to be a way for banks to distinguish themselves from competitors.

Finally, the details of stress testing will need to be re-visited, but S&P said that some banks were already engaged. Almost ten years after the LTCM debacle, S&P believes that losses stemming from the recent credit crisis have been contained. However it cautioned that risk management practices had been outpaced by product development, and needed careful monitoring going forward.

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The dollar has dropped further, on news that Gulf nations intend to diversify their currency reserves

As the dollar goes out of fashion, we expect the euro, sterling and Norwegian krone to benefit

The Canadian dollar is stabilising, though will remain supported by high energy prices for now

Passing the buck: the dollar goes out of fashion

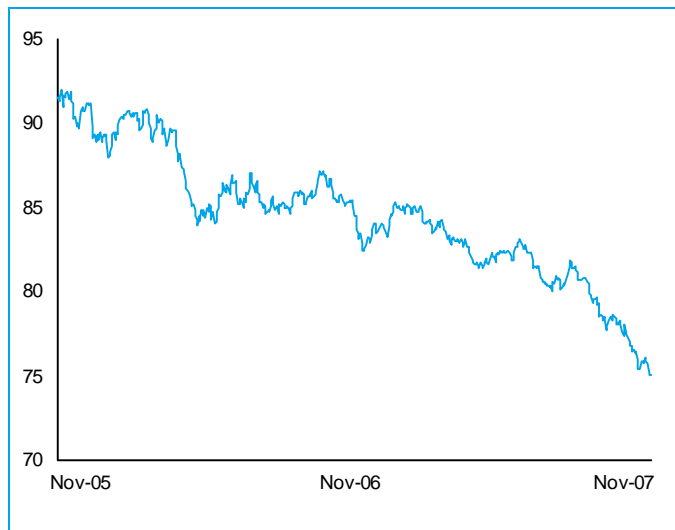
This week, we saw the US dollar weaken further against sterling, yen and the euro. The dollar hit new record lows against the euro on increased global growth concerns. The decline in the US Dollar Index, which compares the dollar with a basket of six leading currencies, is shown in Figure 1.

Early this week, the governor of the central bank of the United Arab Emirates announced that his nation might move away from a dollar peg to a basket peg. Other Gulf nations (Saudi Arabia, Kuwait, Bahrain, Qatar, and Oman) have also indicated that they intend to diversify their currency reserves out of the US dollar towards better-performing holdings, providing an underlying theme for the currency markets this week. These nations noted that the weakening of the dollar has had an increasingly inflationary effect on their economies owing to higher import prices, as their currencies are weakening alongside the dollar. We expect the Gulf nations to take action over the next six months, as the dollar depreciates further.

Meanwhile, although the dollar is at long-term lows against the euro, it is a fair way off recent multi-decade lows (of 2.11) against sterling. This is mainly due to increased bad news in the UK financial sector, coupled with increasingly risk-averse investors moving away from high-yielding currencies and buying back yen in volume. The currencies we expect to benefit from a move away from the dollar are, among others, the euro, sterling and Norwegian krone, which could be used as key currencies in a new pegged basket. Indeed, we have already seen some strength in the aforementioned currencies, which were up versus most majors over the past week. The euro in particular could be supported by this decoupling from the US dollar, since it could potentially make up a third of the basket.

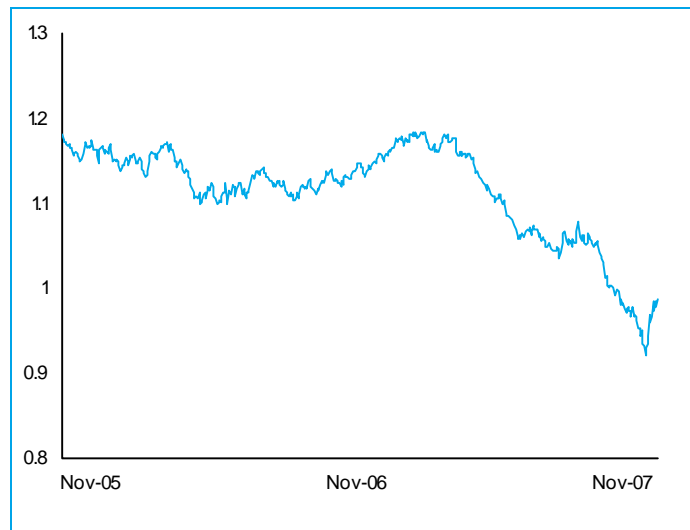
Meanwhile, the Canadian dollar is showing signs of stabilisation, and its rise against the US dollar (up 15% so far this year, as shown in Figure 2) has decelerated as a result. Its rise is now affecting export competitiveness (machinery and industrial exports in particular); the Canadian trade surplus is falling, and is at its lowest since December 1998, at CAD\$2.6 billion. In the longer term, we expect the slowing US economy – which currently makes up 77% of Canadian exports – to begin to weigh on the demand for the Canadian dollar. That said, we do believe the Canadian dollar still has some way to go in the medium term. We think it will be supported by higher energy prices (energy exports make up 19% of Canadian exports) and by the solid domestic economy, although retail sales underperformed forecasts a little this month.

Figure 1 – US Dollar Index



Source: Bloomberg

Figure 2 – CAD/USD



Source: Bloomberg

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The UK analyst portfolio

The UK analyst portfolio is based on each industry analyst's recommendations in their sector. The timeframe for recommendations is fairly long-term in nature (around 12 months). We intend to use this publication to highlight the changes made during the previous week, with an explanation of the decisions made. We will also include news flow on these recommended companies, both events over the past week and any major announcements expected in the week ahead.

Changes to portfolio

Tesco into Morrisons – Tesco has been trading close to our 505p fair value over the course of November after strongly outperforming the sector. The market awaits further information on the US venture at the end of November, but we think the news is already largely included in the share price. Tesco's status as a defensive investment has served our portfolio well since inception amid volatile markets. However, confidence in Morrisons' recovery has improved markedly since recent data showed the northern grocer's sales accelerating impressively over October. We attribute this rediscovered momentum to a much-improved offer and a well-focused new advertising campaign. Morrisons should also benefit from the fact that it has an underused balance sheet, around £7 billion of property backing and a new management that looks much more willing to use these assets to reward shareholders. We have a 348p DCF-based fair value on Morrison, founded on the belief that the business will manage to reach its target operating margins of 5.5%. Consequently, we have reduced Tesco to an -2.1% underweight position to finance a 2.78% overweight in Morrisons.

Experian into Carphone Warehouse – Experian's interim results proved to be the moment that the management admitted that visibility was unlikely to improve until the banking sector itself had visibility on 2008 budgets. This is unlikely to occur before the second quarter of next year. Having downgraded our Experian recommendation to Neutral, we have decided to replace it in the portfolio with Carphone Warehouse, again a stock not without risk, but potentially offering considerable rewards. Carphone trades at over a 25% discount to its European peer group on a 2009 EV/EBITDA basis, widening further in 2010. This implies to us that the market still underestimates the medium-term margin potential of the business, despite the renewed clarity on broadband progression. On 14 times calendarised 2008 numbers, with some 40% forecast earnings growth, Carphone Warehouse looks one of the best-value stocks in either the telecoms or retail sectors. As a result, we are reducing Experian to an underweight position of -0.24% to finance an overweight position of 1.27% in Carphone Warehouse.

News flow

Morrisons' third-quarter sales came in ahead of expectations. Like-for-like sales excluding petrol grew 3.7%, beating the consensus range of 3.2-3.5%, with customers responding well to the new advertising campaign and competitive pricing. One significant positive from these results was the strong cash flow and the resulting reduction in full-year interest charge expectations.

The management of **BAE Systems** remains confident on the outlook for 2007. Importantly – given the current state of the markets – it is also still optimistic about 2008 and beyond. Acquisitions and new order wins have boosted the Land Systems business, and there is the potential for this business to lead to earnings upgrades for 2008. Also, in the US, its electronic business is in a relatively robust area in defence demand. While there is some concern about the outlook for the US defence budget, especially with the presidential elections due in 2008, it is felt that it would be difficult to institute cuts before fiscal year 2010 with current indications that there is upwards pressure on the 2009 budget. BAE's UK Programmes business is progressing as Eurofighter volumes build up. The Saudi order has provided security for the activity in the medium term and extended it longer-term. Further Saudi contracts are expected in due course, turning this into a much larger business for BAE. F35 work is starting, but volumes are projected to ramp up from 2010, and the UK carrier programme should build up through the next decade, although concerns on the UK defence budget may cause delays.

The Saudi order is expected to provide a large advance which, with good cash generation, should place BAE in a very strong position to fund more acquisitions. This adds to the group's growth potential.

Week ahead

Compass Group (final results, 28 November) issued a positive pre-close trading statement in which the group confirmed that it was achieving organic revenue growth of 5% and that operating margins should improve by around 50 to 60 basis points. Thus, the group illustrated that the positive momentum seen in the first half was being maintained into the second half. However, the weakness of the US dollar will have a greater negative impact on profits in the second half. However, since the statement was issued, the group's nearest competitor, Sodexo, has issued a disappointing trading statement indicating that it was suffering from food price inflation and rising central costs. Comments on these issues will be looked for from Compass Group.

Biffa (interim results, 28 November) Biffa shares have performed well in the wake of the positive trading update on 1 October, outperforming the European support services sector by 30%. We are expecting organic growth of 6% in the first half driven by a continued volume and price momentum in the Landfill division. Although there was evidence of stabilisation at the collections division, we are not expecting a significant improvement here, with rising fuel costs and weaker manufacturing activity providing a certain amount of headwind.

Britvic (final results, 29 November) issued an encouraging pre-close trading statement which gave some comfort that the group's trading during the summer were not as bad as feared. We expect few surprises from the results announcement. The group is likely to update on its expectations from the C&C Soft Drinks acquisition and highlight the positive performance of its brand portfolio in the UK. Boosted by synergy benefits from its acquisition, we expect Britvic to deliver strong earnings growth over the next two years.

Bradford & Bingley (pre-close trading, 29 November) in which we have an overweight position in the analyst portfolio, is due to report its pre-close trading statement. Though the shares fell by almost 50% in the five months to mid-October, they have been more stable over the last month. Having met management following new analyst coverage last month, we felt more comfortable that the funding issue hitting a number of specialist lenders was less of a short-term concern for B&B. The group did a good job finding other sources of funds when the wholesale markets dried up, raising £1.8 billion in September in private placements. The recent announcement that it had sold £4.2 billion of home and commercial property loans improves its cash flow and provides further funding in these difficult times.

We appreciate that a number of housing market predictions for 2008 paint a less-than-rosy picture, and with its specialist lending interests, 2008 will be a challenging year for B&B. However, the group has managed itself extremely well though the recent turmoil and given the difficulties experienced by a number of peers, we are comforted by the recent finance-raising initiatives. We expect to hear B&B predict a slowdown for 2008, but it should be able to offset at least some of this slower growth by improved pricing (bolstering margins), as competitors more reliant upon wholesale funding are priced out of the market. While these are extremely challenging times for UK specialist lenders, we think B&B's management should be commended for its reaction to date, and continue to run our overweight position.

Prices and related measures are based on FactSet consensus data and are as at close of business on Thursday 22 November 2007

The O/U WGT column represents the recommended portfolio weight relative to its weight in the FTSE 350

Performance figures are since inclusion in the Focus List, starting from the close of business on 6 September 2007

The Equity Focus List – timely ideas

The aim of the Equity Focus List is to highlight timely equity ideas that we feel warrant particular attention from investors. This is a focused list of recommendations, drawn from the UK sector neutral analyst portfolio. For the continental European recommended stocks, we have drawn from the analysts' Outperform recommendations.

Changes to Focus List

This week we have added Morrisons and Carphone Warehouse to the UK Buy list. Morrisons' Q3 trading statement has confirmed that the business is now gaining momentum with both the core and converted Safeway stores driving strong growth. With its more defensive product offer (little exposure to non-food items and reputation for good value), Morrisons looks well set to outperform into 2008. At Carphone, a dip in the share price over the last week has provided a strong buying opportunity. The shares now trade on 13.8 times calendarised 2008 earnings for over 40% calendarised earnings growth, making it one of the fastest-growing stocks in either the telecoms or retail sectors.

Performance

The Focus List has fractionally outperformed the FTSE 350 this week, helped largely by a strong showing from Britvic.

UK Analyst Focus List

Stocks to Buy

Admiral Group

Non-Life Insurance

Buy

Analyst: Roddy Wallace

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
925.0	1150.0	24.3	20.5	4.0	+5.2	1.9

- Admiral is a very strong motor insurance business, delivering growth of over 20% in the low point of the underwriting cycle. Recent results were excellent.
- Admiral is heavily geared to a turn in the cycle, which we expect soon. Multiples may look high, but are justified by strong growth, good yield and low operational risk.

BHP Billiton

Mining

Buy

Analyst: Paul Singer

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
1489.0	2000.0	34.3	11.4	1.8	-12.5	2.7

- BHP Billiton's potential takeover of Rio Tinto would be strategically sound.
- The stock offers diversified growth and defensive characteristics with exposure to iron ore, coal and a broad range of base metals.

Britvic

Beverages

Buy

Analyst: David Liston

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
338.8	380.0	12.2	16.7	3.2	+4.6	1.0

- The pre-close update confirmed that management is happy with forecasts and we expect the results announcement, due on 29 November, to be positive for the share price.
- The acquisition of C&C Soft Drinks in Ireland offers good synergy benefits and enhances earnings growth prospects for 2008 and 2009.

Carphone Warehouse

General Retail

Buy

Analyst: William Hobbs

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
337.3	420.0	25.0	19.1	1.1	N/A	1.3

- Increased visibility on broadband profits has increased our belief in the medium-term valuation.
- The stock now trades at over a 25% discount to its pan-European peer group on a 2009 EV/EBITDA basis, which looks unjust when one considers that Carphone is set to register calendarised earnings growth of over 40% for at least the next two years.

Compass Group

Beverages

Buy

Analyst: David Liston

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
286.8	380.0	32.5	19.2	3.7	-10.4	1.3

- The new management team has introduced a new strategy, which we believe will lead to a sharp increase in profits.
- The trading statement confirmed organic sales growth of 5% and margin improvement of 60 to 70 basis points. We expect the results announcement, due on 28 November, to be positive for the share price.

Diageo

Beverages

Buy

Analyst: David Liston

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
1082.0	1200.0	10.9	18.0	3.2	+2.1	0.5

- Following a meeting with the CFO, we remain confident of Diageo's growth potential and believe that the shares offer good defensive qualities in today's volatile markets.
- Diageo is holding a seminar on its Scotch whisky business at the end of November, which will highlight the strong growth in global sales and the group's plans to expand its whisky distilling capacity.

Prudential

Life Insurance

Buy

Analyst: Roddy Wallace

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
627.5	870.0	38.6	8.8	2.9	-19.4	0.8

- With concerns over the UK strategy abating, and the capital position improving, we expect the focus to return to the growth potential in the US and Asia.
- Prudential deserves a premium multiple to its peers, due to its growth prospects. Recent consolidation activity amongst its competitors has exposed weakness in the UK-focussed models.

Standard Chartered

Banks

Buy

Analyst: Andy Penman

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
1656.0	1965.0	18.7	17.2	2.3	-3.8	0.8

- Good organic growth opportunities exist from its unique footprint in Asia and the Middle East, supplemented through acquisitions.
- Applying a sum-of-the-parts valuation to the business (using local market competitor ratings), we feel that there is potentially good upside to our 1965p estimate of fair value, which is based on 2008E profit forecasts.

Vedanta Resources

Mining

Buy

Analyst: Paul Singer

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
1900.0	2350.0	23.7	11.5	1.0	-10.8	2.6

- Vedanta is a higher-risk play on growth in the Indian economy and metal consumption. With the commodity metal cycle likely to remain robust, Vedanta stands to benefit from volume growth from both existing and new projects.
- The interim results statement confirmed the encouraging outlook and status of new projects. Takeover speculation is currently driving the stock.

Wm Morrison

Food Retail

Buy

Analyst: William Hobbs

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
293.5	348.0	18.6	23.0	1.8	N/A	2.8

- Current trading is benefiting from a strong advertising campaign and improved offer, which bodes well for momentum going into Christmas.
- The group's strong asset backing, underused balance sheet and defensive product set should see Morrisons outperform the sector in 2008.

WPP

Media

Buy

Analyst: Amanda Purton

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
581.5	835.0	43.6	13.1	2.3	-17.5	1.3

- The market is not giving WPP the benefit of the doubt on forecasts, given fears of a faster slowdown in US advertising. However global advertising forecasts are stable and growth should be higher in 2008.
- The valuation looks attractive on an absolute basis and the shares also trade at a relative discount to peers.

Stocks to Sell**BSkyB**

Media

Sell

Analyst: Amanda Purton

PRICE (P)	FAIR VALUE (P)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE	O/U WGT %
623.0	570.0	-8.5	22.8	2.7	-7.6	-0.6

- The market has focused on good short-term operating metrics following the initial launch of triple-play. We believe that long-term growth forecasts are too optimistic, and concerns about the competitive environment are not reflected in the stock's premium valuation.
- Sky is involved by a number of regulatory reviews. The first, involving its stake in ITV, went against the company, and Ofcom is reviewing Sky's involvement in DTT. More decisions are due in the coming months.

Performance figures are since inclusion in the Focus List, starting from the close of business on 6 September 2007

European ex-UK Focus List

Stocks to Buy

Deutsche Post

Transportation

Accumulate

Analyst: Peter Caldwell

PRICE (€)	FAIR VALUE (€)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE
22.6	28.0	24.2	14.0	3.8	-0.2

- Deutsche Post's attractions lie in the value that we feel management can unlock over the longer term. The commitment to raising the dividend also provides an attractive yield for shorter-term returns.
- Management has set out a credible roadmap explaining how it intends to realise value for shareholders, including guidance which underpins 2008 and 2009 estimates, where self-help will play a significant part. In addition, the commitment to releasing cash from working capital and surplus property suggests there is potential to enhance shareholder returns over the longer term.

Hennes & Mauritz

Retail

Buy

Analyst: William Hobbs

PRICE (€)	FAIR VALUE (€)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE
394.0	485.0	+23.0	25.2	3.4	-3.3

- H&M sources over 60% of its product direct from Asia (compared with only 33% at competitors Inditex). As it is predominantly a euro seller, this means the business actually benefits from a weak US dollar.
- The group has fairly limited operational risk, even in a slower-growth environment, largely due to its low price positioning. The store expansion programme will support overall growth rates.

Swatch Group

Consumer Durables

Buy

Analyst: William Hobbs

PRICE (€)	FAIR VALUE (€)	% TO FAIR VALUE	FY1 PE (X)	FY1 YIELD (%)	PERFORMANCE
301.3	385.0	+27.8	16.1	3.1	-8.6

- Pull-backs in the shares due to fears of a global luxury slowdown have been overdone, offering a rare buying opportunity.
- Swatch share are currently trading at close to a 20% discount to the pan-European peer group. We feel this is unjustified when taking into account Swatch's less economically sensitive target customer.

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