UBS

European equities

COVID-19 update: News from sectors and stocks - oil related

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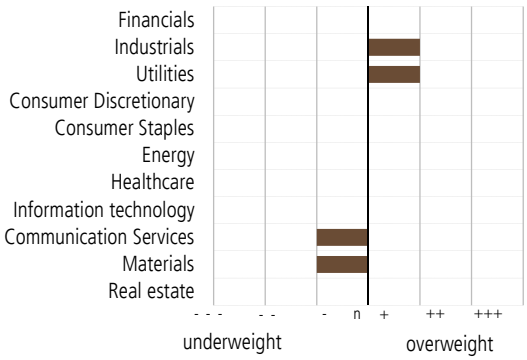
- In our Eurozone sector allocation, we are overweight utilities and industrials. We are underweight communication services and materials.
- After the slump in oil prices, we answer the most urgent questions on the most impacted sectors: energy, chemicals, utilities, and transport.
- We recommend: 1) selectivity among stocks within these sectors, 2) picking stocks with defensive qualities, resilient earnings and sustainable dividends, and 3) stocks that have been oversold. Please check our UBS EQ Radar for topical ideas.

Fig. 1: Eurozone sector allocation
Deviation from benchmark*



*MSCI EMU index. Note: our Eurozone sector weightings are not implemented in our global tactical asset allocation. Source: UBS, as of 17 March 2020. Source: UBS

Our view

European equities have sold off heavily over the last few days. The MSCI EMU index has fallen by 18% in the past week, underperforming global equities, which declined by 14%. Equities fell sharply after governments in France, Germany, Switzerland and Austria announced far-reaching measurements to contain the COVID-19 pandemic. The sell-off has so far not been stopped by policy measures around the globe, which include both rate cuts and fiscal aid.

Year-to date, utilities (-20%) and healthcare (-22%) have been the best performing sectors in the Eurozone, while financials (-44%) and energy (-48%) have been the worst. As COVID-19 continues to disrupt economic activity, the likelihood of a recession increases the longer that severe containment measures last. We expect a substantial impact on European corporate earnings.

Market concerns over COVID-19 have been aggravated by Saudi Arabia's announced increase in oil production. As a consequence, the oil price has tumbled by about 40% to around USD 30/barrel. While this sharp price fall is a strong negative for the performance of the **energy** sector, it has also impacted **chemicals** and **utilities**. **Transport** would normally benefit from lower oil prices, but this time it's different. Nevertheless, we see opportunities within the respective sectors, in high-quality, dividend paying, defensive stocks, and stocks that have been oversold, as highlighted in our UBS EQ Radar.

Sector and stock news – Key issues

1. Energy – Attacked from two sides

Question 1: Are dividends safe?

Market concerns over the hit to demand from the COVID-19 pandemic have been aggravated by the increase in supply following the breakdown of OPEC+ negotiations. This toxic mix has driven Brent oil below USD 30. Last time it was at these levels, in early 2016, it had fallen from over USD 100 15 months earlier. Today, in contrast, the major oil companies that dominate the European energy sector have structurally better profitability and much better investment discipline. This appears to have been ignored by the markets. At the time of the last lows, the distance between the oil price and the free-cash flow breakeven (i.e. considering what is pre-committed for investment and dividends) was USD 50. Today, with much lower FCF break-even at USD 50-60, the gap is only USD 20. Still, stocks are trading at comparable levels to 2015. This implies that the market does not expect any oil price recovery for at least another two years. We are indeed pessimistic that OPEC+ can find an agreement any time soon, and only see a recovery of Brent toward the end of 2020. Our forecast for March 2021 is USD 52. However, this should allow the major integrated oil & gas companies to see through the current situation and to stick to their dividends. Dividends could be cut if oil is still below USD 40 in 2021.

Question 2: What is the most critical aspect to watch?

Besides the oil price, our immediate concern is concentrated on financially leveraged companies. A promising future can well be terminated prematurely by lack of cash or ability to raise debt. However, the global integrated major oil & gas companies went into the year with low leverage, which allows them to lean on their balance sheets. They also have several cushions built in to deal with oil price volatility. This includes integration along the value chain, diversification in agreements with host governments and a relatively high tax burden which now works in their (relative) favor. **Total (Most Preferred)** is in our view the most defensive name, given the resilience of its downstream and low leverage. We previously only selected financially leveraged companies as Least Preferred, but have removed them all as too unpredictable. If the oil price recovers soon, they would be seen as having been saved from the abyss, and their shares could soar. Our Most Preferreds, however, have not changed, as we only selected healthy companies previously.

Question 3: How should investors be positioned?

We go with quality, as the environment is volatile enough still to offer opportunities, even at the relatively conservative end of the sector. **Total** is in our view the most defensive name, given the resilience of its downstream and low financial leverage. **BP (Most Preferred)** is a major with higher debt, but lower capital commitments than peers. So, it is more leveraged to the oil price than Total, but still in a range we feel comfortable with. In Energy Services we only select companies with limited debt and/or well-covered long-term order books. The only Exploration & Production company we select is **Cairn Energy (Most Preferred)**. It is small and dependent on market sentiment. However, it has producing assets that generate cash-flows. It has no debt, and plenty of headroom in undrawn credit lines.

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(please also see our EPL European Energy)

Fig. 2: Equity Radar theme: Forever stab(p)le

We have assembled a selection of stable stocks that should be resilient during times of market weakness but display decent upside when markets bounce back

Most Preferred		
Company	**Sector**	**Country**
Alibaba Group	Comm. Serv.	China
Amazon.com	Cons. Disc.	USA
American Tower	Real Estate	USA
AT&T	Comm. Serv.	USA
Coca-Cola Company	Cons. Staples	USA
Heineken	Cons. Staples	Netherlands
Lindt & Sprüngli	Cons. Staples	Switzerland
Mondelez Int.	Cons. Staples	USA
Novartis	Healthcare	Switzerland
Roche Holding	Healthcare	Switzerland
Singapore Telecom	Comm. Serv.	Singapore
Unilever	Cons. Staples	UK
Vonovia	Real Estate	Germany

Source: UBS Chief Investment Office GWM
Explanation: Comm. Services = Communication Services, Cons. Disc. = Consumer Discretionary, Cons. Staples = Consumer Staples
As our selections may change over time, please always consult the underlying Equity Preference List (EPL) "Equity Radar" for our up-to-date equity preferences. The respective EPL (which also lists the analyst(s) responsible for the selections and the thematic benchmark) can be found on the UBS CIO portal, which can be accessed via the e-banking platform or via Quotes.

2. Chemicals – unprecedented demand shock

Question 1: Why have chemicals recently underperformed?

Year-to-date, European materials (of which chemicals is an important sub-sector) are down by 35%. In the near term the sector faces a severe demand shock, with many key end-markets and intermediate customers likely to halt production: we estimate the auto and aerospace sectors contribute 25% of EU chemicals sector revenues, while oil & gas-related markets add a further 10%. The lower oil price will also lead to destocking through the chemical value chain, weakening apparent demand and lowering utilization rates.

Question 2: What companies are negatively impacted? Which companies are less impacted?

Earnings momentum was already weak across the sector given the industry's significant exposure to Chinese manufacturing. As the virus impact spreads globally this will worsen, and marking spreads to market at Q1 will see companies reduce their guidance. Upstream diversified names are most at risk; specialty and consumer chemicals producers should benefit from lower input prices, although this comes with a lag. The most defensive are the industrial gas companies, whose revenues are partly tied to long-term contracts with energy as a pass-through.

Question 3: How should investors be positioned?

At a sector level chemicals are cyclical with a strong correlation to the autos industry, the largest end-market. This suggests continued underperformance until we see signs that demand is stable or a worst-case outcome is priced in. We advise investors to favor the more defensive end of the sector, such as consumer chemicals and gases (e.g. **Givaudan**, **Air Liquide** and **Linde – all selected as Most Preferred**), and seek out selected specialty chemicals companies that can benefit from input price deflation or more defensive end-markets (e.g. **DSM**, **Akzo Nobel – all selected as Most Preferred**). We do not yet recommend taking a strongly pro-cyclical stance ahead of any anticipated recovery. Companies with weaker balance sheets will likely remain under pressure; we do not advise chasing high dividend yield in the sector.

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3. Utilities – commodity price weakness unhelpful

Question 1: Why have utilities underperformed recently?

Year-to-date, European utilities are down by 16%, while the MSCI Europe declined by 28%. But European utilities were not immune to volatile market developments. Last week, the sector was down by 22% and underperformed European equities overall. An important reason for the sector underperformance was the oil price decline. From early to mid-March 2020 the price fell by about 40% (from around USD 50/barrel to just under USD 31/barrel at 16 March 2020). This has a negative impact on other commodity prices like coal and natural gas, which, in turn, are driving wholesale power prices down.

Question 2: What companies are negatively impacted? Which companies are less impacted?

Lower wholesale power prices are a negative for traditional power producers like **Fortum (Least Preferred)** or **EDF**. But it does not impact renewable producers. Should power prices remain lower for longer,

Fig. 3: Equity Radar theme: Opportunities in Europe

We recommend a selection of European stocks with attractive valuation and rebound potential as well as certain defensive characteristics

Most Preferred		
Company	**Sector**	**Country**
Deutsche Post	Industrials	Germany
Diageo	Cons. Staples	UK
Credit Agricole	Financials	France
Credit Suisse	Financials	Switzerland
L'Oreal	Cons. Staples	France
LVMH	Cons. Disc.	France
SAP	IT	Germany
SGS	Industrials	Switzerland
Unilever	Cons. Staples	UK
Volkswagen	Cons. Disc.	Germany
Zurich Insurance Group	Financials	Switzerland

Source: UBS Chief Investment Office GWM
Explanation: Comm. Services = Communication Services, Cons. Disc. = Consumer Discretionary, Cons. Staples = Consumer Staples, IT = Information Technology
As our selections may change over time, please always consult the underlying Equity Preference List (EPL) "Equity Radar" for our up-to-date equity preferences. The respective EPL (which also lists the analyst(s) responsible for the selections and the thematic benchmark) can be found on the UBS CIO portal, which can be accessed via the e-banking platform or via Quotes.

sector earnings trends could modestly decline. But regulated and quasi-regulated utilities should not see a bigger earnings impact from recent negative commodity price weakness.

Question 3: How should investors be positioned?
We think utilities are a defensive sector with a large amount of regulated assets like electricity and gas networks as well as quasi-regulated assets like renewables. Regardless of the virus impacts, we think that the energy transition, with its focus on the de-carbonization of energy production, will remain the dominant sector trend in the coming years. Increased investments in networks and renewables should still lead to solid sector earnings trends with ongoing good visibility. Dividend yields of more than 5% for the sector are attractive and should generally remain sustainable. As a consequence, we think select asset are mispriced and see the current weakness as an opportunity for long-term oriented investors. Companies like **Enel (Most Preferred)**, **Iberdrola** and **RWE (Most Preferred)** should continue to deliver good earnings growth going forward.

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4. Transportation – in the eye of the storm
Question 1: Why has transport recently underperformed?
The sector has suffered disproportionally during the recent market sell-off. At present, the impact of COVID-19 is very negative for airlines as customers are cancelling flights across the world and governments have implemented travel bans in major destinations in Europe as well as for European visitors to the US. This situation has forced European airlines to reduce capacities by between 75% and 90%. Although the lower oil price would normally help as fuel costs represent on average 30% of sales, in the current situation it is less relevant. The focus of airlines is all about cash management to mitigate negative consequences and in a worst-case avoid bankruptcy.

Question 2: Which companies are worst impacted? Which companies are least impacted?
All European airlines are massively negatively affected. The only difference among them is currently how strong their balance sheets are. Although we believe there will be structural winners in this consolidation process, at present it is very hard for us to assess the full impact of COVID-19. We have **Air France / KLM** selected as **Least Preferred** due to a weaker balance sheet, and **Flughafen Zurich** and **Getlink** (ex-Eurotunnel) both Least Preferred due to increasing travel restrictions.

Question 3: How should investors be positioned?
Within the transport sector we like **Deutsche Post (Most Preferred)**. Its Express business should benefit from the recovery we are currently seeing in Asia (an important region for this business). We like also **Vinci (Most Preferred)**. The company has several links to transportation. It is one of the largest toll road operators in France and one of the largest airport operators globally (diversified in terms of countries). In recent weeks the stock has been under heavy pressure due to the exposure to travel. However, the strong balance sheet and resilient business model with long duration concessions makes it an attractive investment in our view.

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UBS Equity Radar and UBS Equity Compass publications

Please see UBS Equity Radar publication, EPL Equity Radar, and UBS Equity Compass, along with various sector and regional EPLs, for more information on selected short-term themes and stock selections.

We highlight the following Equity Radar themes:

Forever stab(p)le (see Fig. 2)
The COVID-19 coronavirus outbreak has disrupted economic activity. This will lead to weaker earnings trends. It has also fueled uncertainty and equity market volatility. Now is the time to invest in sectors/stocks that display resilient earnings growth trends. Consumer staple and healthcare companies meet these criteria—their products are consumed daily, and consumption is growing, while demand is very much independent from economic cycles. We have assembled a selection of stable stocks that should be resilient during times of market weakness but display decent upside when markets bounce back.

Opportunities in Europe (see Fig. 3)
European markets have fallen sharply as concerns increase over the spread of the coronavirus COVID-19. As the virus spreads further outside China, China looks to stabilize, and we look for stocks that could benefit from a market rebound if the overall situation calms down. After the current correction, we recommend quality companies with solid cash flows, good fundamentals and exposure to emerging markets. The main risk to selection remains the COVID-19 pandemic lasting longer than expected with very severe economic implications.

Appendix

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Appendix

UBS CIO GWM equity selection system
We provide two equity selections: Most Preferred (MP) and Least Preferred (LP).

Most preferred
We expect the stock to outperform the benchmark in the next 12 months.
Least preferred
We expect the stock to underperform the benchmark in the next 12 months.
Suspended
Sometimes legal, regulatory, contractual or best-business-practice obligations restrict us from issuing research on a company. This situation normally stems from UBS Investment Bank's involvement in an investment banking transaction associated with that company.
Equity selection: An assessment relative to a benchmark
Equity selections in Equity Preferences lists (EPLs) are assessments made relative to a sector/industry, country/regional or thematic benchmark. The chosen benchmark is disclosed on the front page of each EPL. It is also used to measure the performance of the individual analyst. Including a stock in the EPL constitutes neither a view on its expected, standalone absolute performance nor a price target. Rather, EPLs are meant to support the UBS House View, with the stocks included in them selected for their superior risk/return profiles.
Our selection is based on an assessment of the company's fundamental outlook and valuation, the risks owning the stock entails and the diversification benefits it provides in an investment portfolio, among many other factors. UBS WM CIO's selection methodology enables wealth management clients to invest in a specific investment theme or focus on a sector/industry or country/region.
Stocks can be selected for multiple EPLs. For consistency's sake, a stock can only be selected as either Most Preferred or Least Preferred, not both simultaneously. As EPL benchmarks differ, stocks do not need to be included on every list to which they could theoretically be added.
Only stock views prepared by UBS Financial Services Inc. (UBS FS) which are compatible with the above equity selection system are provided. A stock cannot be selected as Most Preferred if it is rated Sell, while a Buy-rated stock cannot be selected as Least Preferred.
Whenever CIO has an investment view (such as with the tactical asset allocation TAA) on an entire country/region, or sector/industry on a three to 12-month time horizon, we state our preference by using the terms overweight, neutral and underweight.
For more information about our present and past recommendations, please contact ubs-cio-wm@ubs.com

Current UBS CIO global rating distribution (as of last month-end)	
Least Preferred	10%
Most Preferred	90%

Current UBS global rating distribution (as of last month-end)	
Buy	44.63% (32.57%*)
Neutral	39.78% (28.76%*)
Sell	13.48% (22.66%*)
Suspended	2.08% (56.86%*)
Discontinued	0.04% (100.00%*)

Appendix

Rating history table - part 1 (last 12 months)

Release date	Company name	Equity Preference List	Current selection	Previous selection
Mar 05 2020	Alibaba	Technology Disruption	Most Preferred	Not Listed
Aug 02 2019	Alibaba	Technology Disruption	Not Listed	Most Preferred
Jul 01 2019	Alibaba	Technology Disruption	Most Preferred	Not Listed
Nov 27 2019	Alibaba	Industry consolidation in China – The big getting bigger	Most Preferred	Not Listed
Nov 20 2019	Alibaba	Industry consolidation in China – The big getting bigger	Not Listed	Most Preferred
Sep 12 2019	Alibaba	Industry consolidation in China – The big getting bigger	Most Preferred	-
Nov 27 2019	Alibaba	China	Most Preferred	Not Listed
Nov 20 2019	Alibaba	China	Not Listed	Most Preferred
Jan 15 2020	Alibaba	EPL Equity Radar	Most Preferred	Not Listed
Feb 19 2020	Alibaba	EM ESG Winners	Most Preferred	-
Nov 27 2019	Alibaba	AxJ Focus 20	Most Preferred	Not Listed
Nov 20 2019	Alibaba	AxJ Focus 20	Not Listed	Most Preferred
Nov 27 2019	Alibaba	APAC Portfolio Populator	Most Preferred	Not Listed
Nov 20 2019	Alibaba	APAC Portfolio Populator	Not Listed	Most Preferred
Aug 21 2019	Alibaba	China's lower-tier cities – The next growth engine	Not Listed	Most Preferred
Jan 15 2020	Amazon.com	EPL Equity Radar	Most Preferred	Not Listed
Nov 22 2019	American Tower	US REITs	Most Preferred	Not Listed
Mar 12 2020	American Tower	EPL Equity Radar	Most Preferred	-
Feb 27 2020	American Tower	Sustainable investing	Not Listed	Most Preferred
Mar 12 2020	AT&T Inc.	EPL Equity Radar	Most Preferred	Not Listed
Feb 06 2020	AT&T Inc.	EPL Equity Radar	Not Listed	Most Preferred
Aug 22 2019	AT&T Inc.	EPL Equity Radar	Most Preferred	Not Listed
Nov 01 2019	Coca-Cola Co.	US Consumer staples	Most Preferred	-
Nov 14 2019	Coca-Cola Co.	USA	Most Preferred	-
Mar 12 2020	Coca-Cola Co.	EPL Equity Radar	Most Preferred	-
Jan 13 2020	Credit Agricole	Eurozone	Most Preferred	-
Jan 15 2020	Credit Agricole	EPL Equity Radar	Most Preferred	Not Listed
Jan 13 2020	Credit Agricole	European Banks	Most Preferred	Not Listed
May 17 2019	Credit Suisse Group	Swiss withholding-tax-free distributions	Not Listed	Most Preferred
Feb 28 2020	Deutsche Post	EPL Equity Radar	Most Preferred	Not Listed
Dec 05 2019	Deutsche Post	EPL Equity Radar	Not Listed	Most Preferred
Aug 26 2019	Deutsche Post	EPL Equity Radar	Most Preferred	Not Listed
Dec 10 2019	Deutsche Post	European Industrials	Most Preferred	Not Listed
Aug 26 2019	Deutsche Post	EM(U) Winners	Most Preferred	Not Listed
Nov 13 2019	Diageo	Dividend Investing UK	Not Listed	Most Preferred
Aug 26 2019	Diageo	EPL Equity Radar	Most Preferred	Not Listed
Apr 17 2019	Diageo	EPL Equity Radar	Not Listed	Most Preferred
Mar 12 2020	Heineken	EPL Equity Radar	Most Preferred	Not Listed
Mar 05 2020	Heineken	EPL Equity Radar	Not Listed	Most Preferred
Aug 14 2019	Heineken	EPL Equity Radar	Most Preferred	Not Listed
Sep 09 2019	L'Oréal	Eurozone	Most Preferred	Not Listed
Aug 12 2019	L'Oréal	Resilient & stable stocks	Most Preferred	-
Feb 28 2020	L'Oréal	EPL Equity Radar	Most Preferred	Not Listed
Sep 06 2019	L'Oréal	Sustainable investing	Most Preferred	Not Listed

Source: UBS

Appendix

Rating history table - part 2 (last 12 months)

Release date	Company name	Equity Preference List	Current selection	Previous selection
Mar 05 2020	Lindt & Spruengli	EPL Equity Radar	Most Preferred	Not Listed
Mar 27 2019	Lindt & Spruengli	EPL Equity Radar	Not Listed	Least Preferred
Mar 05 2020	Lindt & Spruengli	European Consumer Staples	Most Preferred	Not Listed
Nov 05 2019	Lindt & Spruengli	European Consumer Staples	Not Listed	Least Preferred
Mar 05 2020	Lindt & Spruengli	Switzerland	Most Preferred	Not Listed
Nov 05 2019	Lindt & Spruengli	Switzerland	Not Listed	Least Preferred
Dec 11 2019	LVMH Moet Hennessy Louis	EPL Equity Radar	Most Preferred	Not Listed
Jun 27 2019	LVMH Moet Hennessy Louis	EPL Equity Radar	Not Listed	Most Preferred
Apr 17 2019	LVMH Moet Hennessy Louis	EPL Equity Radar	Most Preferred	Not Listed
Nov 01 2019	Mondelez International	US Consumer staples	Most Preferred	Not Listed
Aug 15 2019	Mondelez International	US Consumer staples	Not Listed	Most Preferred
Nov 14 2019	Mondelez International	USA	Most Preferred	Not Listed
Aug 15 2019	Mondelez International	USA	Not Listed	Most Preferred
Mar 12 2020	Mondelez International	EPL Equity Radar	Most Preferred	-
Feb 27 2020	Mondelez International	Sustainable investing	Most Preferred	Not Listed
Mar 12 2020	Novartis AG	EPL Equity Radar	Most Preferred	Not Listed
Jul 30 2019	Novartis AG	EPL Equity Radar	Not Listed	Most Preferred
Mar 12 2020	Roche Holding AG	EPL Equity Radar	Most Preferred	Not Listed
Mar 05 2020	Roche Holding AG	EPL Equity Radar	Not Listed	Most Preferred
Apr 03 2019	Roche Holding AG	EPL Equity Radar	Most Preferred	Not Listed
Jan 17 2020	Roche Holding AG	SDGs	Most Preferred	-
Feb 27 2020	Roche Holding AG	Sustainable investing	Most Preferred	Not Listed
Feb 28 2020	SAP AG	EPL Equity Radar	Most Preferred	Not Listed
Jan 15 2020	SAP AG	EPL Equity Radar	Not Listed	Most Preferred
Aug 14 2019	SGS	EPL Equity Radar	Most Preferred	Not Listed
Sep 02 2019	SGS	Switzerland	Most Preferred	Not Listed
Mar 12 2020	Singapore Telecom	EPL Equity Radar	Most Preferred	Not Listed
Mar 27 2019	Singapore Telecom	EPL Equity Radar	Not Listed	Most Preferred
Sep 30 2019	Singapore Telecom	Shelter from the storm	Most Preferred	-
Mar 06 2020	Singapore Telecom	AxJ Focus 20	Most Preferred	Not Listed
Jul 26 2019	Singapore Telecom	AxJ Focus 20	Not Listed	Most Preferred
Feb 28 2020	Unilever PLC	EPL Equity Radar	Most Preferred	-
Aug 21 2019	Unilever PLC	UK	Most Preferred	Not Listed
Feb 27 2020	Unilever PLC	Sustainable investing	Not Listed	Most Preferred
Sep 06 2019	Unilever PLC	Sustainable investing	Most Preferred	Not Listed
Sep 23 2019	Volkswagen Preference	Eurozone sustainable high dividend yield	Not Listed	Most Preferred
Feb 28 2020	Volkswagen Preference	EPL Equity Radar	Most Preferred	Not Listed
Jan 06 2020	Volkswagen Preference	Germany	Most Preferred	Not Listed
Sep 23 2019	Vonovia	Eurozone sustainable high dividend yield	Not Listed	Most Preferred
Feb 06 2020	Vonovia	EPL Equity Radar	Most Preferred	Not Listed
Sep 26 2019	Vonovia	EPL Equity Radar	Not Listed	Most Preferred
Apr 23 2019	Zurich Insurance Group	European Insurance	Most Preferred	-
Feb 28 2020	Zurich Insurance Group	EPL Equity Radar	Most Preferred	Not Listed
Dec 05 2019	Zurich Insurance Group	EPL Equity Radar	Not Listed	Most Preferred

Source: UBS

Terms and Abbreviations

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
A	actual i.e. 2010A	COM	Common shares
E	expected i.e. 2011E	MP	Marketperform: The stocks expected performance is in line with the sector benchmark

Appendix

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
NAV	Net asset value	Shares o/s	Shares outstanding
UP	Underperform: The stock is expected to underperform the sector benchmark	CIO	UBS WM Chief Investment Office

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