S&P CAPITAL IQ

Lookout Report
from Global Markets Intelligence

The U.S. Economy Is Showing Signs Of Stability, But We're Not Out Of The Woods Yet

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The Lookout Report is a compendium of current data and perspectives from across S&P Capital IQ and S&P Indices covering corporate earnings, market and credit risks, capital markets activity, index investing, and proprietary data and analytics. Published bi-weekly by the Global Markets Intelligence research group, the Lookout Report offers a detailed cross-market and cross-asset view of investment conditions, risks, and opportunities.

The U.S. economy is showing welcome signs of stability at the start of the third quarter following widespread weakness in the second quarter. While it's too early to conclude that the economy has emerged from the "soft patch," recent data nonetheless suggest that economic conditions have not continued to deteriorate in July and early August, in our view.

While the manufacturing purchasing managers' index (PMI) from the Institute for Supply Management (ISM) remained below the neutral 50 level (49.8) in July for the second month in a row, the services PMI held steady and actually increased slightly in July to 52.6 from 52.1 in June. So while conditions in the service sector appear to have stabilized in recent months, according to the ISM, the latest readings remain much lower than the much healthier average level of 54.9 recorded over the first six months of this year, suggesting weak current-quarter GDP growth at best (see "Market Intellect: With An Economy On The Edge, Where Do We Go From Here?," published July 6, 2012, on the Global Credit Portal).

The U.S. July employment report was also net-positive news, from our perspective. While the U.S. unemployment rate increased to 8.3% from 8.2% in June, total nonfarm payroll employment increased by 163,000 new jobs in July, posting the strongest gains since 259,000 in February. The recovery in payrolls returns the three-month average rate of job creation back above the 100,000 level (104,670), which we believe is the minimum rate of job creation necessary if the U.S. economy is to avoid recession this year and next.

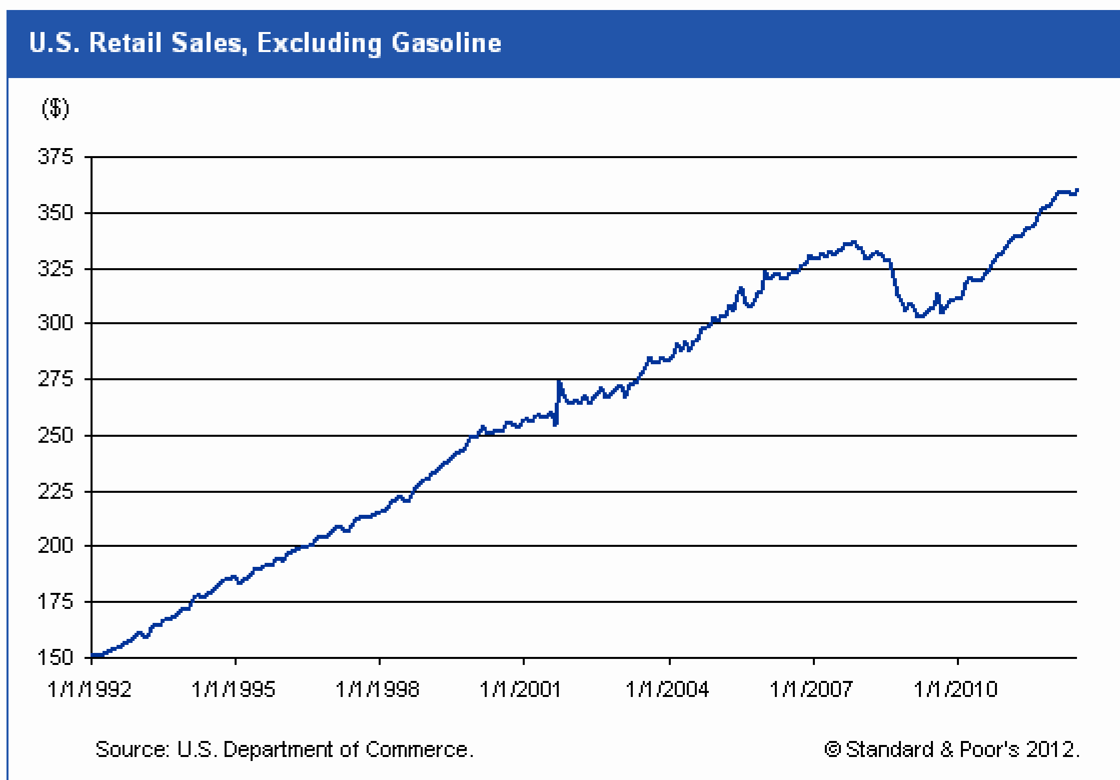
U.S. initial jobless claims are another example of an economic indicator for which the absence of news is good news. Jobless claims were last reported at 366,000, resulting in a four-week average of 363,750, which remains within the average range of 363,000 to 387,500 that has prevailed since the start of 2012. Our position on jobless claims continues to be that the U.S. economy lacks the fundamental strength required to sustain a weekly jobless rate below the 350,000 level. However, we also do not want to see claims rise above the 400,000 level, since this would suggest further deterioration of U.S. employment conditions.

At face value, the 0.8% monthly increase in headline July retail sales appeared to be a strong report, but the July increase came on the heels of the 0.7% decline recorded in June. So in reality, the two months essentially cancel each other out. Seasonally adjusted July sales of

$403.93 billion are in the vicinity of the $404.1 billion in April and the $403.6 from May when the economy started slowing. Nevertheless, the July retail sales report is a positive following three consecutive negative reports recorded in April through June. However, Global Markets Intelligence (GMI) Research sees further reasons for optimism in the July retail sales report.

As we said in a prior edition of the Lookout Report, volatile retail gasoline prices have recently hurt U.S. retail sales (see "Lookout Report: U.S. Recession Risks And The Outlook For Markets In The Second Half Of 2012," published June 25, 2012). Total retail sales (excluding gasoline) increased by 0.85% in July following a 0.4% decrease in June, with July being the strongest month-to-month increase this year. Retail sales ex-gasoline also posted a new all-time record high of $360.5 billion in July, the fourth such record in 2012 (see chart 1), suggesting U.S. consumers continue to support economic growth.

Chart 1



Recent economic data, on average, suggest that conditions are not worsening as we progress through the third quarter. The economy needs to sustain nonfarm payroll growth well in excess of 100,000 jobs per month before we are willing to conclude that the economy has emerged from the second-quarter "soft patch." The weak manufacturing PMIs and the improved but still largely subpar services PMIs suggest to us that we remain in a tenuous high-risk economic and market environment where the economy could still end up teetering on the brink of recession in late 2012 or the first half of 2013. Over the past two weeks, investors have taken encouragement from receding credit risks across Europe (post-Draghi) in addition to stabilizing U.S. macroeconomic fundamentals, despite ever-present structural challenges facing global policymakers. Both of these recent trends need to continue if risk assets are going to see sustained demand from investors over the second half of this year. We continue to believe that the S&P 500 Index can end this year at 1,450, or even slightly higher, so long as the economy continues to distance itself from recession.

Inside This Issue:

Macroeconomic Overview

The U.S. economy is showing welcome signs of stability at the start of the third quarter following widespread weakness in the second quarter. While it's too early to conclude that the economy has emerged from the "soft patch," recent data nonetheless suggest that economic conditions have not continued to deteriorate in July and early August, in our view.

Economic And Market Outlook: North American And European Earnings

With 476 S&P 500 companies having reported second-quarter earnings results, the season is all but over. Growth for the quarter currently stands at 0.90%. The beat rate for earnings has held strong at 65%, higher than the 10-year average of 62%, while only 41% of companies were able to beat revenue expectations, much lower than the 10-year average of 61%.

International Update: Enfeebled Economy And Investment Barriers Make The Indian Stock Market Uninviting

India may have achieved some modest improvement in inflation recently, accompanied by resurgence in Sensex market total returns (16.4% increase in rupees and 10.7% in U.S. dollars; see chart). However, an anemic outlook for the national economy and a sharp decline in foreign direct investment signal potentially acute currency weakness, symptomatic of a prolonged period of internal economic adjustment. Such a scenario could prove discouraging for bond and stock investors alike.

S&P Index Commentary: Global Sales In The S&P 500 Index

In 2002, S&P Indices removed foreign companies from the S&P 500 Index, rendering the index a pure U.S. play, in line with Standard & Poor's indices for other countries. However, a company classified as U.S.-based does not imply that it is not global. While company reports often show the company's globalization, exact sales and export levels are difficult to obtain.

Leveraged Commentary And Data: Issuers Chip Away At Loan Maturities Via A Refi Flood

In the month to date, arrangers have launched about $11.2 billion of institutional loans, versus $19.9 billion in all of July and a paltry $1.4 billion in August 2011, after Standard & Poor's Ratings Services' downgrade of U.S. debt rocked global markets and put a damper on new issuance. Meanwhile, the high-yield market has been on fire, with $19.2 billion of deals printing in the month to date, versus $21.2 billion in all of July and $7.3 billion in August 2011.

R2P Corporate Bond Monitor

The latest round of global data releases shows that European activity is the main drag on the global economy. Amid a worldwide economic slowdown, risk-reward profiles--as measured by average R2P scores--deteriorated across the board since the beginning of August with decreasing returns and increasing market risk. The score decline was even sharper in Europe.

Market Derived Signal Commentary: The Credit Market Looks Past Rising Corn, Soybean Prices

The GMI research team wanted to see if five-year CDS spreads for the packaged foods and meats industry had widened in concert with rising commodity prices. To serve as a proxy for the industry, we looked at the trading patterns of the spreads year to date through Monday for the top five companies in the industry by market capitalization, according to S&P Capital IQ.

Capital Market Commentary: A Review Of Technology IPOs

The GMI research team examined the performance of U.S. tech IPOs with proceeds of $500 million or more that came to market since Google's debut in August 2004. We found that Facebook shares have slumped by more than 42%, while Freescale Semiconductor Ltd. shares have gained more than 20%.

S&P Index Commodity Commentary: Energy And Backwardation Lead Index Gains In August

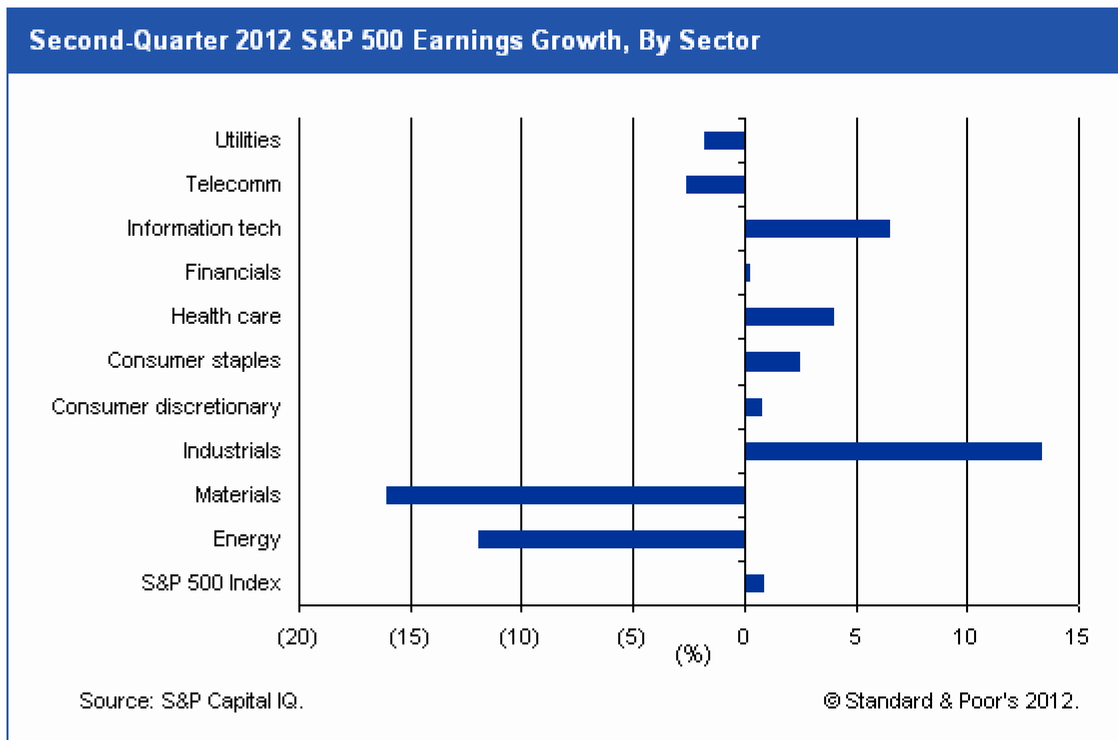
The energy sector has led a recovery in commodities in August, as agriculture prices have declined. Supply concerns remain a key issue as Middle East tensions have been a main driver of petroleum price gains. Backward shaped futures curves have boosted commodity investor returns, subsequently adding to total returns for the index.

Economic And Market Outlook: North American And European Earnings

North America

With 476 S&P 500 companies having reported second-quarter earnings results, the season is all but over. Growth for the quarter currently stands at 0.90%, in-line with GMI's call in the Aug. 3 edition of the Lookout Report for a final growth rate that was positive but still less than 1% (see "Lookout Report: U.S. Structural Challenges Are Threatening Economic Growth And Prosperity," published Aug. 3, 0212). The beat rate for earnings has held strong at 65%, higher than the 10-year average of 62%, while only 41% of companies were able to beat revenue expectations, much lower than the 10-year average of 61%. Despite a low growth rate and a majority of companies missing revenue targets, the season is concluding with figures that are better than originally expected. On July 9, the unofficial kick-off of earnings season, earnings growth was pegged to come in at negative 2%, with seven of the 10 sectors expected to post negative growth figures. The season has ended much better than where it began, with only four sectors in the red: materials (negative 16.02%), energy (negative 11.96%), telecommunications (negative 2.63%), and utilities (negative 1.78%). The two greatest laggards in the second quarter, the materials and energy sectors, are also expected to be the biggest losers in the third quarter, both down by more than 20%. Second-quarter strength came from the industrials (13.35%) and information technology (6.56%) sectors (see chart 2).

Chart 2



Several S&P 500 retailers reported earnings results this week. Analysts expect the consumer discretionary sector to post low year-over-year growth of 0.84%, while they forecast slightly better growth of 2.51% for consumer staples. Of the 13 retailers that reported this week, 11 beat earnings estimates, while only one met and one missed. On the top-line, only five companies were able to beat revenue expectations, while eight missed, in-line with the broader trend in the S&P 500 Index. Among the retailers, discount stores proved to be the real winners in the second quarter, posting earnings growth of 13.2%, while department stores disappointed with negative growth of 18.6%. The retailers received some positive news on Tuesday, when retail sales for July came in better than expected at 0.8%, the strongest reading since February. Back to school shopping, the second largest shopping period after the winter holidays, helped to boost gains. This typically boosts third-quarter earnings for consumer discretionary companies; the sector is expecting much improved earnings growth of nearly 5% next quarter and an impressive 17.1% in the fourth quarter due to holiday sales (see chart 3).

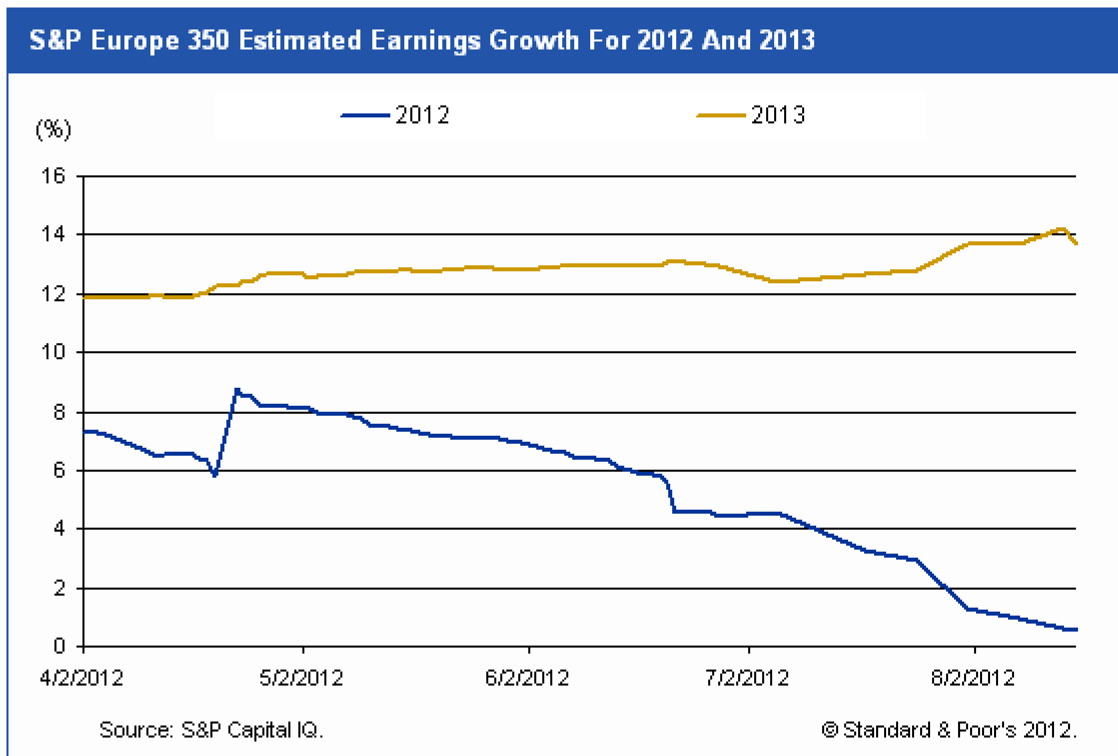
Chart 3

With only 24 companies left to report, investors are looking ahead to the second half of the year. Estimates for the third quarter continue to fall, with analysts now expecting earnings growth of negative 1.8%. Fourth-quarter estimates have remained steady at 10.3% for the last two weeks, although we would be surprised to see double-digit earnings growth by the end of the year considering recent trends.

Europe

In the past week, calendar-year 2012 estimates for the S&P Europe 350 Index have declined by 43 basis points (bps), to 0.53% from 0.96%. This is in comparison to expectations at the beginning of the second quarter (April 2) that called for robust year-over-year growth of 7.28%. Currently, analysts anticipate that five (energy, materials, health care, information technology, and telecommunication services) of the 10 sectors will report negative growth for 2012 (see chart 4).

Chart 4

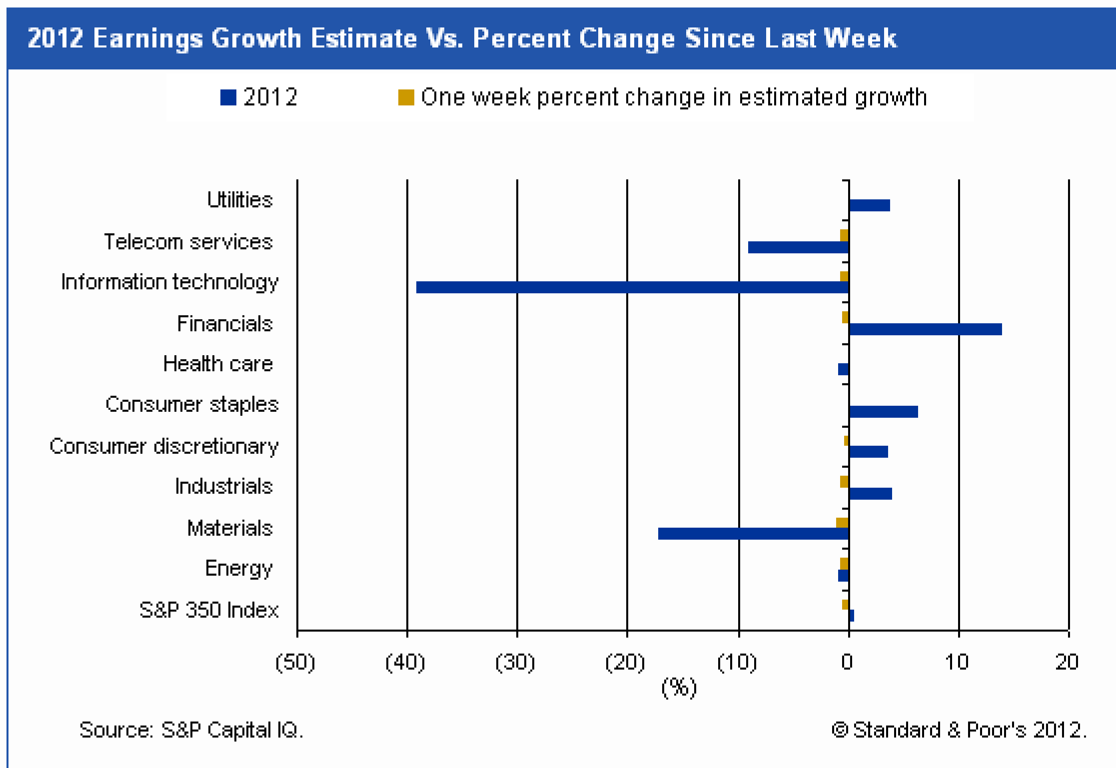


A 1.63% decline in expected growth for the materials sector led the downturn in estimates over the past week. As seen in the S&P 500 Index, analysts expect the S&P 350 materials sector to be one of the weakest in 2012, currently estimated to post negative growth of 17.2%, with S&P 500 materials companies expecting negative growth of 8%. Of the 36 materials companies within the S&P 350 Index, five have reported either first-half or second-quarter results in the last week. Of those five companies, two have exceeded estimates (ThyssenKrupp AG and Rio Tinto PLC), while three companies (Randgold Resource, Salzgitter AG, and CRH PLC) missed estimates by €0.23, €0.59, and €0.12, respectively. The large misses by these three companies largely contributed to the overall decline in the index growth rate.

It is particularly alarming that estimates are now lower than 1%, given the easy year-over-year comparisons. In 2011, the S&P Europe 350 Index reported a 2% drop in earnings. Given the downward trend in estimates, many investors worry 2012 could mark the second year of falling earnings for European corporations.

Analysts expect the information technology (negative 39.16%), materials (negative 17.18%), and telecommunication services (negative 8.96%) sectors to be the biggest laggards for the S&P 350 Index in 2012 (see chart 5). Currently, analysts only expect the financials (13.96%) sector to report strong double-digit growth for the year, followed by consumer staples, at 6.43%.

Chart 5



Despite the 0.43 percentage point drop for 2012 earnings expectations last week, analysts have only lowered 2013 estimates by 0.2 percentage points, to €105.49. This still produces a very robust growth rate of 13.7% for next year, with all 10 sectors expecting positive growth. Furthermore, analysts expect the energy, materials, industrials, consumer discretionary, financials, and information technology sectors to post double-digit growth.

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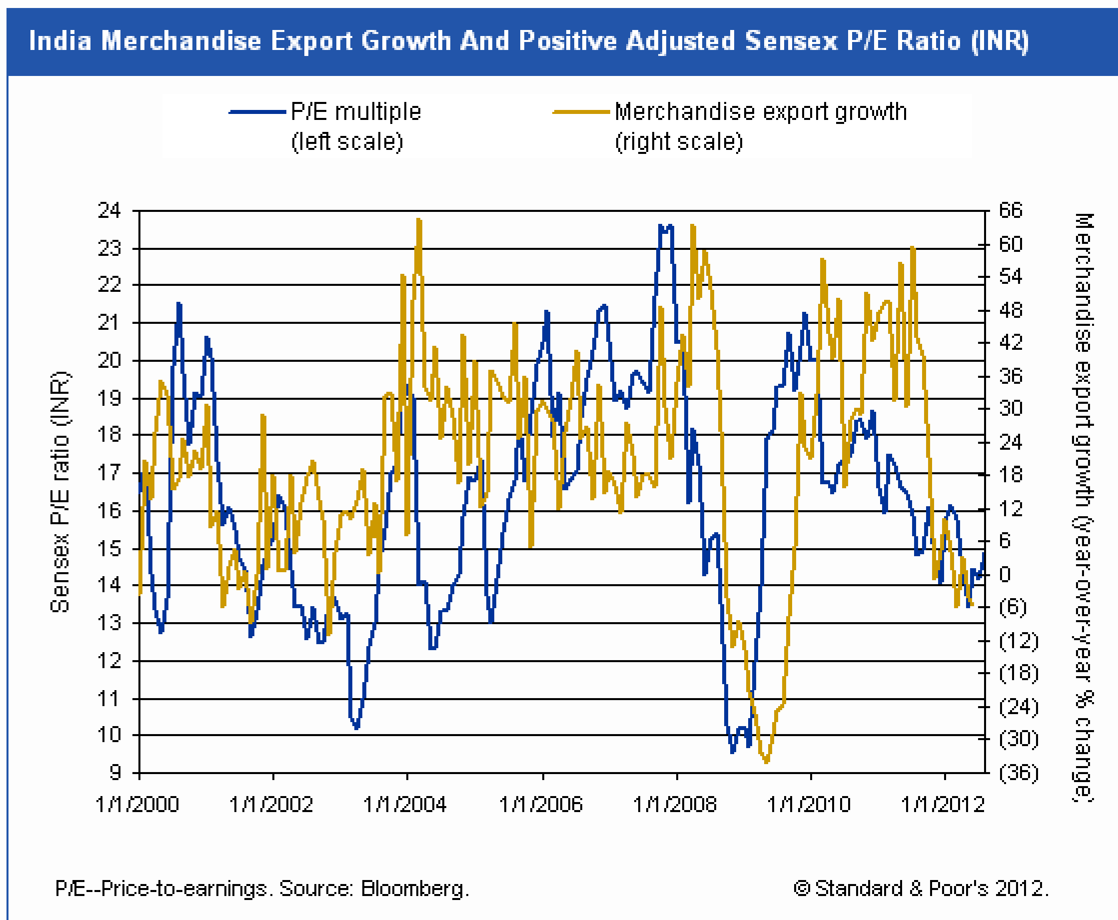
International Update: Enfeebled Economy And Investment Barriers Make The Indian Stock Market Uninviting

Debilitating macroeconomic conditions and inhospitable investment environments could soon transcend enthusiasm for Indian shares and eventually depress domestic equity performance, in our opinion. India may have achieved some modest improvement in inflation recently, accompanied by resurgence in Sensex market total returns (16.4% increase in rupees and 10.7% in U.S. dollars; see chart 6). However, an anemic outlook for the national economy and a sharp decline in foreign direct investment signal potentially acute currency weakness, symptomatic of a prolonged period of internal economic adjustment. Such a scenario could prove discouraging for bond and stock investors alike.

The splintered multiparty ruling coalition under Prime Minister Manmohan Singh has strived to push through much-needed reforms of the financial and retail sectors to promote national competitiveness through increased foreign direct investment and tighter domestic credit conditions. Nevertheless, Singh's government (now in its second term) has run directly into opposition from left-wing and nationalist alliance members, both of which have stood in the way of some of the most basic of his market liberalization proposals. Although the Reserve Bank of India (RBI) has enjoyed a measure of autonomy to pursue a counter-inflationary monetary policy, its tight credit stance has accomplished little at checking

double-digit price pressures at the retail level.

Chart 6



Considering the obstacles facing policymakers in New Delhi, the ongoing rally in Indian shares appears counterintuitive--if not outright anomalous--in the absence of any duly sympathetic macroeconomic underpinnings. With the nation's real GDP growth having receded to 5.3%, industrial output having slid into negative territory, and exports having plummeted as well, no fundamental evidence supports the market upturn. In fact, patterns in economic data favor nothing more than a reversal in domestic equity market trends.

Moreover, from a valuation standpoint, India's 2012 forward price-to-earnings (P/E) multiple (13.9x)--currently 42%, 35%, and 30% higher than that of South Korea (9.8x), China (10.3x), and Hong Kong (10.7x), respectively--appears entirely unjustifiable, irrespective of the fact that it is well below its historical average (16.4x) and high (23.6x) and just 435 bps above its 12-year low (9.6x). In contrast, Mumbai's comparative inexpensiveness against the exchanges of Kuala Lumpur, Manila, and Taipei seems reasonable given the relatively more auspicious economic patterns and policymaking milieu in Malaysia, the Philippines, and Taiwan. Thus, in light of the economic headwinds restraining the Indian economy, investors would do better from exposures to the less expensive Chinese, Hong Kong, and South Korean stock markets (see table 1).

Table 1

Asia Forward P/E Multiples And Relative Valuations*

	--2012--		--2013--	
	P/E	**Under/over**	**P/E**	**Under/over**
Australia	12.28	1.62	11.07	1.22
China	10.33	3.57	8.86	3.43
Hong Kong	10.67	3.23	9.76	2.53
Indonesia	13.59	0.31	11.64	0.65
India	13.90	-	12.29	-
Japan	13.65	0.25	12.54	(0.25)
Malaysia	15.18	(1.28)	13.77	(1.48)
New Zealand	13.98	(0.08)	12.14	0.15
Philippines	16.36	(2.46)	14.53	(2.24)
Singapore	14.15	(0.25)	12.96	(0.67)
South Korea	9.84	4.06	8.49	3.80
Taiwan	15.10	(1.20)	12.81	(0.52)
Thailand	12.75	1.15	10.95	1.34
S&P Asia 50	10.59	3.31	9.49	2.80

*Under/over relative valuations versus India. P/E--Price-to-earnings. Source: Bloomberg.

Although the domestic economy may not be favoring shares investing and entrenched political interests opposed to India's reform are unlikely to subside, highly selective areas of equity investment should remain long-term strategic targets for investors. Improving the country's decrepit infrastructure, for instance, will be a top priority policy objective for some time to come, along with enhancements of telecommunications and transportation networks. Indeed, last month's electrical blackout across much of the nation highlighted the need for upgrading India's power grid, all of which investors would be well-advised not to overlook when diversifying their portfolios.

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S&P Index Commentary: Global Sales In The S&P 500 Index

In 2002, S&P Indices removed foreign companies from the S&P 500 Index, rendering the index a pure U.S. play, in line with Standard & Poor's indices for other countries. However, a company classified as U.S. does not imply that it is not global. While company reports often show the company's globalization, exact sales and export levels are difficult to obtain. Many companies tend to categorize sales by regions or markets, while others segregate government sales. In addition, intra-company sales (profits) are sometimes structured to take advantage of trade, tax, and regulatory policy. The resulting reported data available for shareholders are therefore significantly less substantial than needed for any sort of comprehensive analysis. Using available data, Standard & Poor's offers annual reports on foreign sales that provide a rare glimpse into global sales composition. Nevertheless, investors should not consider the reports statements of exact values.

Total reported foreign sales for 2011, as a percentage of full sales, increased to 25.2% from 24.6% in 2010 and 24.1% in 2009. These values include issues that have not fully reported their foreign data, and therefore underestimate the actual values. For comparison, we also calculated the values using only the subset of issues that reported full information. These issues paint a different picture, with the reported issues posting their third consecutive year of percentage declines. For those issues, foreign sales as a percentage of full sales decreased slightly to 46.1% from 46.3% in 2010, 46.6% in 2009,

and 48% in 2008. The slight decrease would appear to be statistically small, with non-quantifiable amounts due to volatile changes in currency rates, membership, and contracts (see table 2).

Table 2

S&P 500 Index--Percent Of Total Sales

(%)	2011	2010	2009	2008	2007	2006	2005
Consumer discretionary	42.28	42.98	42.43	44.05	42.46	38.76	37.28
Consumer staples	46.99	45.61	46.56	46.95	39.06	36.57	37.51
Energy	39.29	38.86	43.66	50.47	55.69	56.50	56.62
Financials	34.67	37.05	40.19	34.09	31.59	29.93	31.36
Health care	52.42	49.82	47.21	48.61	44.54	41.76	37.54
Industrials	47.96	45.06	44.21	46.14	44.11	41.14	39.68
Information technology	56.52	56.30	56.02	55.27	55.38	53.50	54.86
Materials	53.71	52.46	52.06	49.66	46.99	42.22	40.81
Telecommunication services	N.M.	18.68	15.10	N.M.	N.M.	N.M.	N.M.
Utilities	N.M.	84.29	81.97	52.18	55.16	63.60	60.48
Total non-U.S. 15% to 85%	46.14	46.29	46.57	47.94	45.84	43.55	43.26

N.M.--Not meaningful. Source: S&P Indices.

Information technology continued to dominate the sectors, with 56.5% of its sales coming from abroad, representing 19% of all declared foreign sales. Energy companies slightly increased reported foreign sales to 39.3% from 38.9% in 2010, but that was still lower than 43.7% in 2009 and 60% in 2003. Given the current volatility of oil and potential regulatory changes, additional exploration and production for the energy sector could shift (based on political and regulatory changes) in the coming years, but eventual final sales of the refined product may remain dominant in the U.S. Few companies in the telecommunications and utilities sectors provided revenue breakdowns, resulting in a lack of meaningful statistics.

Regional data show that European sales decreased to 11.1% of all sales from 13.5% in 2010. Sales for Europe (ex-the U.K.) fell to 8.7% in 2011 from 12% in 2010, revealing the impact that the European recession is having on U.S. issues. Asian sales increased to 15.2% from 13.1% in 2010.

In 2009, S&P 500 companies paid slightly more in income tax payments to Washington than they did to foreign entities. In 2010, more payments went abroad than to Washington (see table 3). The trend continued in 2011, with S&P 500 issues sending $142 billion to foreign entities for income taxes and $117 billion to Washington--a mix of 54.7% paid to foreign entities and 45.3% domestically, placing the U.S. government in a minority holder position of income tax receipts. Tax policy has become a major issue, even before election posturing started, with the current trend working against the U.S.

Table 3

S&P 500 Index 2011 Income Taxes Paid

	2011	2010	2009	2008	2007	2006	2005
Foreign (mil. $)	141,639.34	117,340.62	91,876.46	135,128.60	123,610.30	112,686.35	91,793.80
U.S. (mil. $)	117,337.35	101,661.94	92,667.16	107,204.88	151,104.41	155,269.46	141,470.74
Foreign--change (%)	20.71	27.72	(32.01)	9.32	9.69	22.76	27.19
U.S.--change (%)	15.42	9.71	(13.56)	(29.05)	(2.68)	9.75	40.94

Source: S&P Indices.

While European sales are down, they are still a major component of U.S. sales. However, growth expectations have been

scaled back, as more attention is being paid to U.S. domestic sales. Retail issues show the impact of declining sales more quickly, since consumers can swiftly decide to change spending habits. It can take months for a business to decide to make a major purchase, such as specialized heavy industrial machinery or farm equipment, with their impact slower to materialize (see table 4).

Table 4

S&P 500 Index Foreign Sales, By Region

	--2011--		--2010--		--2009--	
	Foreign sales (mil. $)	Percent of foreign sales (%)	Foreign sales (mil. $)	Percent of foreign sales (%)	Foreign sales (mil. $)	Percent of foreign sales (%)
Africa	208,602.42	7.95	148,102.91	6.47	160,558.97	7.94
Asia	407,380.78	15.52	300,064.53	13.11	356,738.51	17.65
Australia	11,953.14	0.46	6,024.55	0.26	5,439.10	0.27
Europe	630,172.17	24.01	666,398.21	29.12	516,690.32	25.57
North America	248,427.38	9.47	104,115.36	4.55	157,659.43	7.80
South America	148,820.35	5.67	97,628.29	4.27	108,749.72	5.38
Foreign Countries	969,180.58	36.93	966,145.31	42.22	715,175.75	35.39
Total	2,624,536.83	100.00	2,288,479.17	100.00	2,021,011.81	100.00

Source: S&P Indices.

The full report, S&P 500 Global Sales, is available on our web site, www.spdji.com under Consult S&P Indices.

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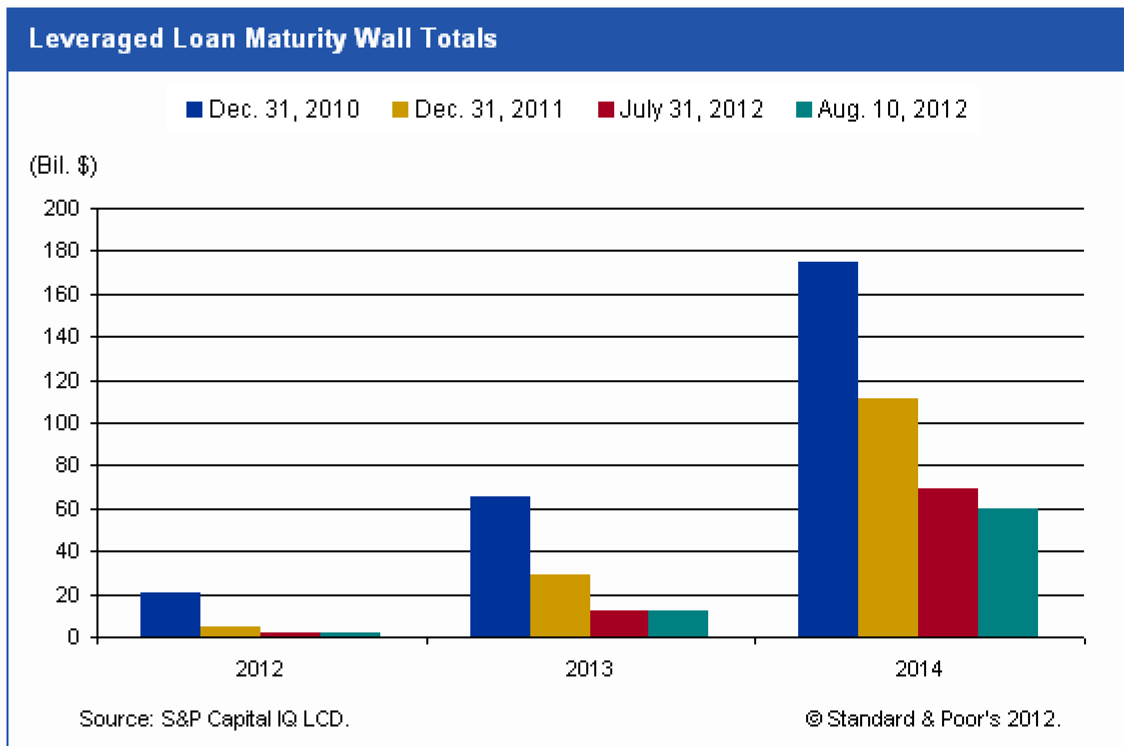
Leveraged Commentary And Data: Issuers Chip Away At Loan Maturities Via A Refi Flood

So much for the dog days of summer. Leveraged loan and high-yield issuers have been busy during the traditionally slow month of August, taking advantage of strong technicals and a period of relative calm in both Europe and the U.S.

In the month to date, arrangers have launched about $11.2 billion of institutional loans, versus $19.9 billion in all of July and a paltry $1.4 billion in August 2011, after Standard & Poor's Ratings Services' downgrade of U.S. debt rocked global markets and put a damper on new issuance. Meanwhile, the high-yield market has been on fire, with $19.2 billion of deals printing in the month to date, versus $21.2 billion in all of July and $7.3 billion in August 2011.

A good deal of this activity has targeted near-term maturities. So far this month, issuers have completed or announced opportunistic transactions that address $9.8 billion of loans maturing in 2014, according to LCD (see chart 7). These include bond-for-loan takeouts, amend-to-extend exercises, and loans to refinance shorter-dated loans. Some executions have been large, with Community Health Systems, ServiceMaster, and First Data poised to clear away more than $1 billion apiece of their 2014 maturities.

Chart 7

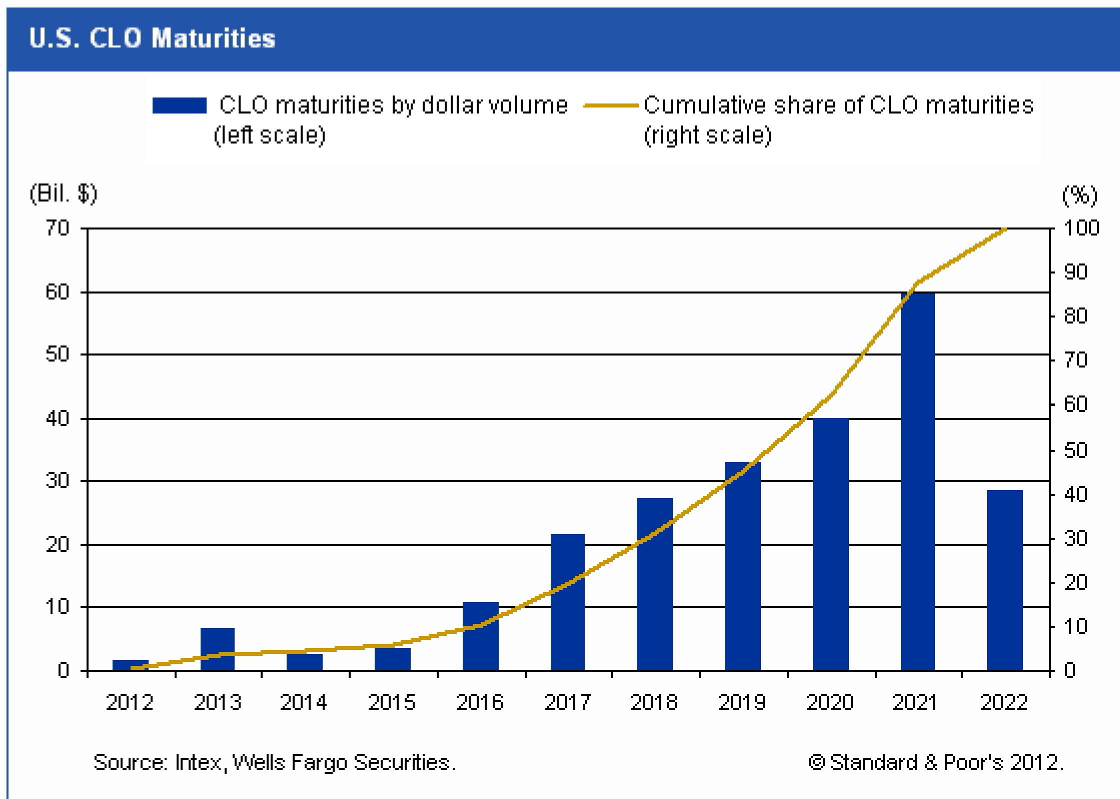


This month's refinancing business trims the 2014 maturity wall by 14% from the end of July, shrinking the cliff to $59.5 billion. That amount is less than a third of the 2014 wall in 2009, when it totaled $223 billion.

With the pool of shorter-dated loans shrinking, there is a strong bid for shorted-dated paper from CLOs as they work to maintain compliance with weighted-average-life tests, traders note.

Roughly 31% of the CLO universe matures in 2018 or earlier, according to data from Wells Fargo and Intex (see chart 8).

Chart 8



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R2P Corporate Bond Monitor

The latest round of global data releases shows that European activity is the main drag on the global economy. The Japanese economy grew 0.3% in the second quarter of 2012, half as much as expected, according to Reuters, as Europe's debt crisis weighed on export demand and consumer spending. Similarly, Chinese export growth was close to zero in July. Growth will brake sharply throughout the world in the coming years, according to the Center for Economics and Business Research (CEBR). The CEBR added that the weakening global situation will affect even the fast-growing emerging economies, while the GDP growth rate in China, which reached double digits for much of the last decade, will fall to 7% by 2016. The CEBR downgraded global growth for 2013 by 0.5% to 2.7%, with the eurozone facing another year of recession (see table 5).

Table 5

Estimated Growth Rates For 2013

	(%)
U.S.	1.7
Canada	2.1
Brazil	3.1
Eurozone	(0.1)
U.K.	0.7
Eastern and Central Europe	3.4

Table 5

Estimated Growth Rates For 2013 (cont.)	
Africa 8 Group	4.6
Middle East	3.4
China	7.6
India	6.0
Asian Group	4.4

Source: Center for Economics and Business Research.

Hopes of a further round of easing by major central banks have slightly countered the worries over the global economy. ECB President Mario Draghi raised hopes for fresh intervention two weeks ago when he said the bank was "ready to do whatever it takes to preserve the euro." Meanwhile, Germany, Europe's biggest economy, is waiting with eurozone partners for the report on Greece from a so-called troika of inspectors. Their verdict, which is expected by mid-September, will determine if Athens receives the next installment of €31.5 billion in rescue funds.

There have been little if any major negative headlines out of the U.S. since the beginning of August. The number of workers filing applications for jobless benefits has averaged 365,000 these past two weeks, suggesting that labor market conditions may be stabilizing, according to the U.S. Department of Labor.

In this context of worldwide economic slowdown, risk-reward profiles--as measured by average Risk-to-Price (R2P) scores--deteriorated across the board since the beginning of August with decreasing returns and increasing market risk (see tables 6 and 7). The score decline was even sharper in Europe.

In North America, scores decreased by 1% as a result of a 5% increase in the average 20-day historical bond price volatility and a tightening in the average option-adjusted spread (OAS) of 2 bps, offsetting the 8% decrease in the average probability of default (PD).

In Europe, scores decreased overall by 8% as a result of an 11% increase in the average bond price volatility, a 13% increase in the average PD, and a tightening in the average OAS of 3 bps.

Table 6

North American Risk-Reward Profiles By Sector--Average R2P Score And Components Changes

	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	1	2	(8)	6
Consumer staples	1	(4)	6	3
Energy	(4)	(5)	(10)	8
Financials	(3)	1	(2)	8
Health care	(3)	(3)	(32)	0
Industrials	2	(4)	(12)	5
Information technology	5	9	4	2
Materials	(4)	(13)	(12)	3
Telecommunication services	1	(7)	(17)	5
Utilities	(11)	4	2	8

Change as of July 31, 2012, from Aug. 10, 2012.

Table 7

European Risk-Reward Profiles By Sector--Average R2P Score And Components Changes

	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	0	(9)	(16)	8
Consumer staples	(12)	1	(7)	18
Energy	(16)	3	82	(2)
Financials	(5)	(1)	18	8
Healthcare	(14)	7	22	13
Industrials	4	9	(25)	23
Information technology	(17)	(40)	(6)	15
Materials	(7)	1	23	5
Telecommunication services	(9)	(5)	9	7
Utilities	(9)	3	31	15

Change as of July 31, 2012, from Aug. 10, 2012.

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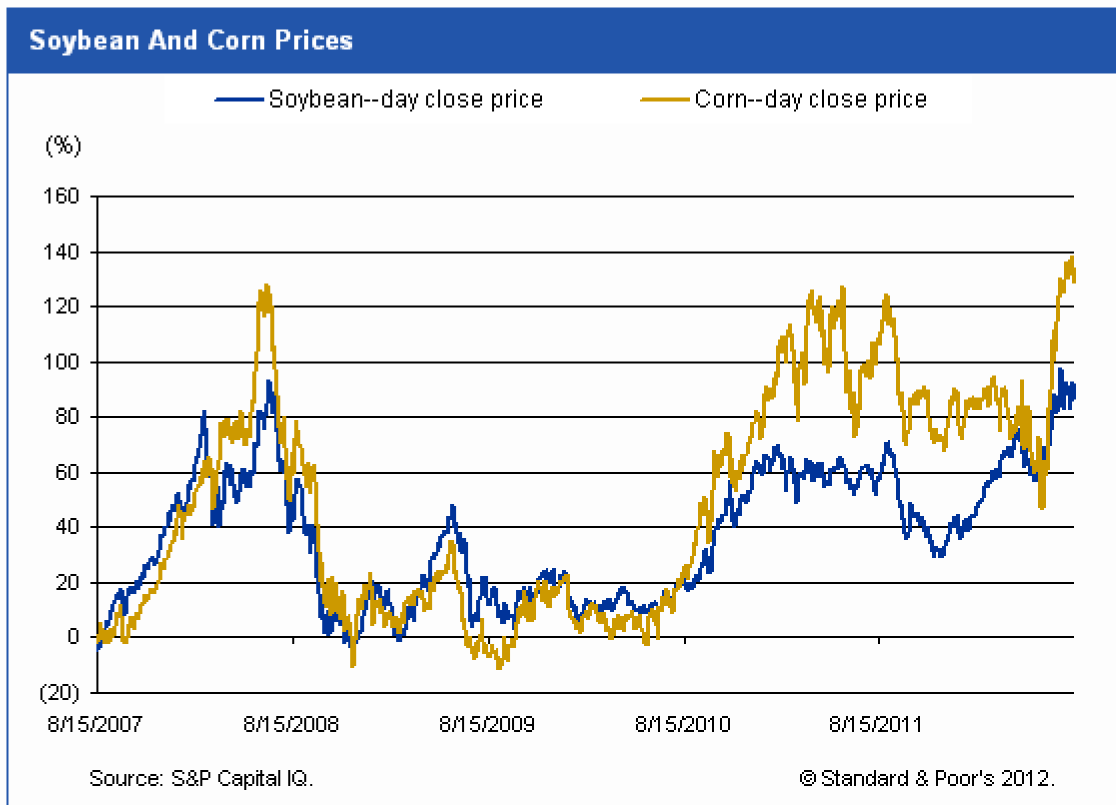
Market Derived Signal Commentary: The Credit Market Looks Past Rising Corn, Soybean Prices

On the back of a severe drought, the USDA on Aug. 10 said it expects the lowest yielding corn crop in 17 years. The government agency reduced its output forecast to 123.4 bushels per acre from 166 in June and raised the high end of its price forecast by 39% to $8.90. The USDA also said it sees a 12% decline in soybean production to 2.69 billion bushels, and expects an average per acre yield of 36.1, which would be the lowest since 2003.

Over the past three months alone, corn prices have surged 39%, surpassing the June 26, 2008, record of $7.88 a bushel, and futures prices aren't indicating a near-term end to these levels, according to data from the Chicago Board of Trade. Year to date, corn has appreciated 20%. Soybean prices have climbed 30% so far this year to $15.98 per bushel, a level also seen in 2008 (see chart 9).

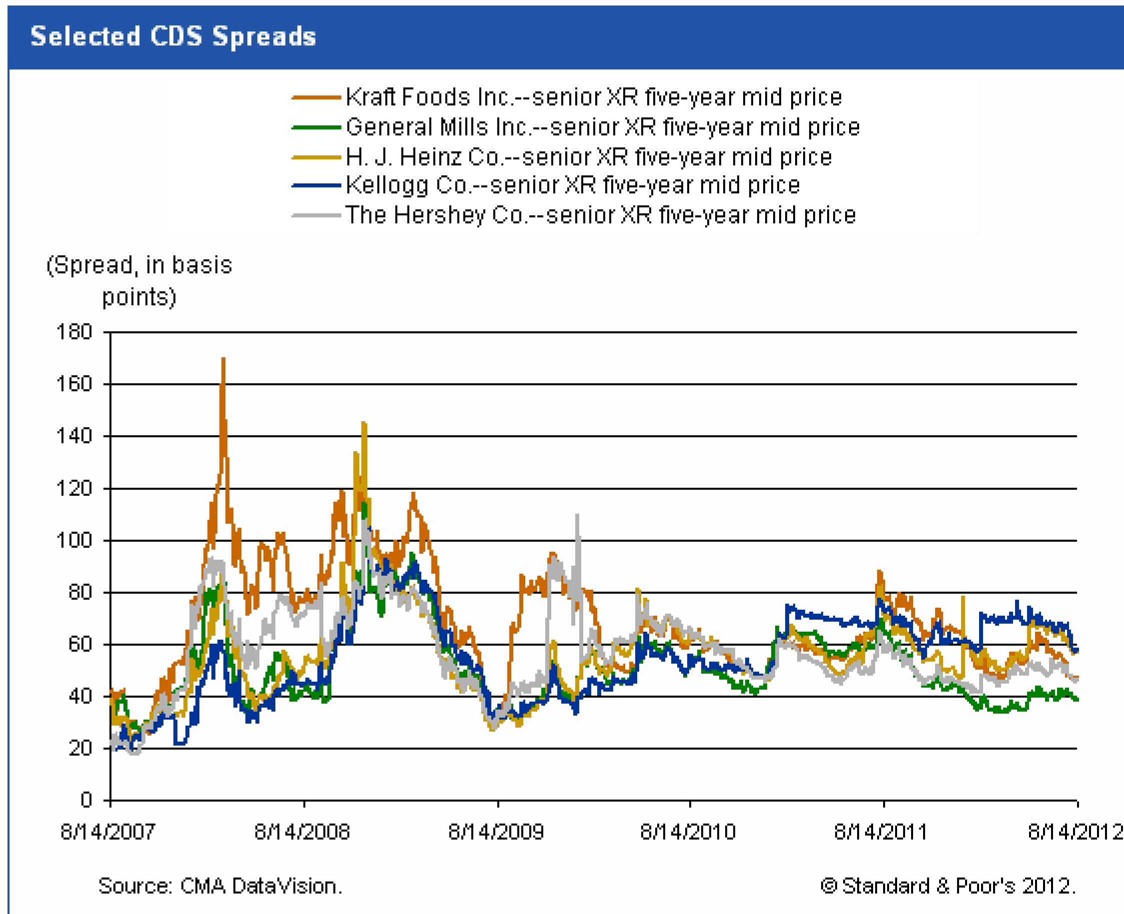
Chart 9



The GMI research team wanted to see if five-year credit default swap (CDS) spreads for the packaged foods and meats industry had widened in concert with rising commodity prices. To serve as a proxy for the industry, we looked at the trading patterns of the spreads year to date through Monday for the top five companies in the industry by market capitalization, according to S&P Capital IQ.

We found CDS spreads for Kraft Foods Inc. (-28.08%), Kellogg Co. (-3.63%), and General Mills Inc. (-8.68%) tightened, while those for The Hershey Co. (3.64%) and H.J.Heinz Co. (18.57%) widened as of Aug. 14 (see chart 10). Since all five CDS remain in high-grade territory, this suggests to us that the credit market has already priced in the risk, and that differentials in trading patterns may reflect company-specific issues or merely the credit market re-pricing risk to what it sees as a more appropriate level.

Chart 10



At this time, the GMI research team does not see any signs that the credit market is overly concerned about the direction of commodity prices; indeed, investors seem to view packaged foods and meats companies as among the least likely to default in the corporate universe. There are caveats: If corn and soybean price increases continue apace, they may eventually reach a level the market can't support. Additionally, a recession in the U.S., which we peg at a 50% chance, could cause the spreads for this industry to blow out to levels last seen in 2008 and 2009. As always, we will continue to monitor the trading patterns in this industry.

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Capital Market Commentary: A Review Of Technology IPOs

As the eight-year anniversary of Google Inc.'s $1.66 billion IPO as well as the expiration of Facebook's IPO lockup period approach, how have some of the largest IPOs in the technology sector recently fared? The GMI research team examined the performance of U.S. tech IPOs with proceeds of $500 million or more that came to market since Google's debut in August 2004. We found that Facebook shares have slumped by more than 42%, while Freescale Semiconductor Inc. shares have gained more than 20% (see table 8). (Freescale shares dropped nearly 30% in calendar-year 2011 and remain below their offer price of $18.)

Since Facebook's IPO, seven U.S. information technology companies have filed plans to go public. The most recent, Cyrus Networks LLC made a $300 million offering proposal on Aug. 8. Over the same time span, five U.S. tech companies have

scrapped plans for IPOs.

Table 8

Largest U.S. Tech IPOs Since Google's Debut-- Performance Since Facebook IPO

Effective date	Target/Issuer	Value (mil. $)*	Price change (%)§
5/24/2011	Freescale Semiconductor Ltd.	783.0	20.7
2/14/2005	Wright Express Corp.	720.0	15.0
10/12/2006	SAIC Inc.	1,125.0	12.6
3/18/2008	Visa Inc.	17,864.0	11.6
6/28/2005	NeuStar Inc.	605.0	10.0
5/24/2006	Mastercard Inc.	2,399.3	6.8
8/18/2004	Google Inc.	1,666.4	5.9
3/21/2012	Vantiv Inc.	500.0	2.3
8/13/2007	VMware Inc.	957.0	(2.6)
5/17/2012	Facebook Inc. (since offer price of $38 on May 17)	16,006.9	(42.6)

*Total transaction value. §From May 17, 2012, to Aug. 13, 2012. Source: S&P Capital IQ.

M&A

The upswing in private equity transactions continues. The Carlyle Group's recent $3.3 billion acquisition of Getty Images Inc. marks the 13th financial sponsor purchase of more than $1 billion this year. That compares to 11 LBOs of that size in the year-ago period. Collectively, the billion-dollar plus LBO total announced this year has exceeded $34 billion, compared with $29 billion for the aggregate value of billion-dollar plus financial sponsor acquisitions occurring in the comparable year-ago periods. Additionally, the share of private equity relative to all announced U.S. M&A transactions continues to rise. More than 11% of the dollar volume of U.S. deal activity so far this year derives from financial sponsor activity, the highest proportion at this stage in the year since 2007 (see table 9).

Table 9

Merger Volume

	U.S. M&A (bil. $)	U.S. LBOs (bil. $)	LBOs (%)
2007	1,023.8	349.1	34.1
2008	602.4	30.5	5.1
2009	427.8	8.6	2.0
2010	479.5	49.9	10.4
2011	679.3	50.4	7.4
2012	449.9	51.1	11.4

Each year through Aug. 15. Source: S&P Capital IQ.

Fixed-Income

The rate of identifier requests for certain debt securities continued to display sluggishness, according to information provided by CUSIP Global Services. CUSIP demand fell for six of seven asset classes in the week ended Aug. 10 from the preceding week (see table 10). On first impression, these findings suggest the potential for perhaps a tepid period ahead for debt underwriting. On the other hand, data from different time periods suggest prospects may be better. For example, since the end of March 2012, year-over-year CUSIP orders for domestic corporate debt show a 2.65% gain. Similarly, international debt CUSIP requests this year have recently showed signs of life. Since the end of April 2012, international

debt identifier orders are running 11% ahead of the period from the close of 2011 to present.

Table 10

Selected CUSIP Requests By Security Type

Security type	Week ended Aug. 10, 2012	Week ended Aug. 3, 2012	2012ytd	2011ytd	Year-over-year change (%)
Domestic corporate debt	179	443	6,662	6,590	1.09
Municipals	281	319	10,718	7,487	43.15
Long-term note (more than one year)	10	43	349	258	35.27
Short-term note (less than one year)	31	84	935	1,023	(8.60)
International debt	27	24	982	1,080	(9.07)
PPN domestic debt	34	61	1,381	1,139	21.25
PPN international debt	1	15	233	219	6.39
Total	563	989	21,260	17,796	19.47

Source: CUSIP Global Services.

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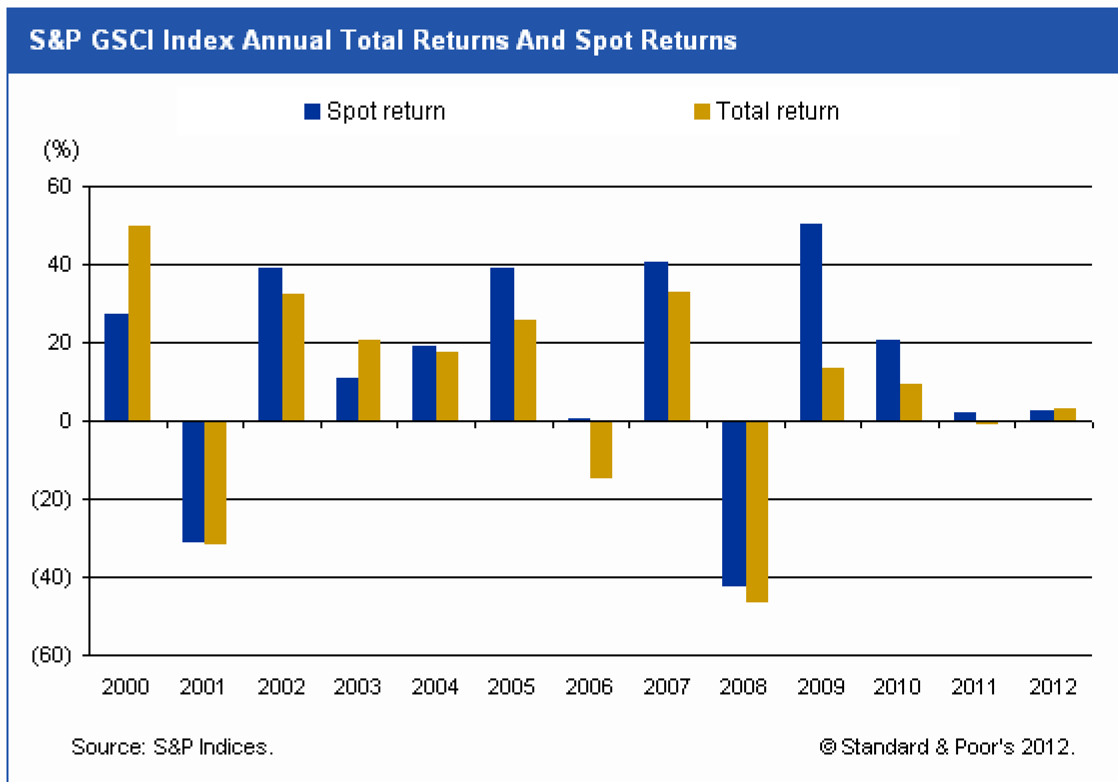
S&P Index Commodity Commentary: Energy And Backwardation Lead Index Gains In August

The S&P GSCI Index has continued to recover in August, increasing 4.33% on the month (as of Aug. 15) and reaching the highest level since May. While the drought-stricken agriculture sector has dominated the headlines this summer, the recovering energy sector has led index returns since the beginning of July. Grains are down 1.37% in August as of yesterday's close, while energy is up 8.67% on the month. Year to date, the grains have been the best performing sector, but energy has been the best performer since the beginning of the third quarter.

Increasing Middle East tensions have helped to raise petroleum prices 8.3% in August and 14.14% in the third quarter, as measured by the S&P GSCI Petroleum Index. Among S&P GSCI commodities, the S&P GSCI Unleaded Gas Index represents one of the best performers in 2012 on a total return basis, with a 24.45% gain, exceeded only by the S&P GSCI Corn and Wheat indices.

Global demand and refinery disruptions in the U.S. have been key drivers of unleaded gas returns, in addition to the positive return due to rolling into backwardation (when further out futures trade at lower prices). Backwardation normally is a result of tight supply/demand conditions. The spot S&P GSCI Unleaded Gas Index has gained only 8.69% in 2012, resulting in a roll return near 15.76%. Reflecting increasing supply concerns, many of the energy and agriculture constituent future term structures have moved toward, or deeper into, backwardation, thus boosting index total returns. Year-to-date, the S&P GSCI Total Return Index improved to a gain of 2.95%, exceeding the spot index increase of 2.67%. The S&P GSCI Petroleum Total Return Index has gained 1.98% in 2012, compared with a 1.21% gain for the spot index. New historic highs in corn and wheat have coincided with a positive roll return near 4.15% for the S&P GSCI Agriculture Index, as measured by the 20.01% increase in the total return index, compared with 15.86% in the spot index. 2003 marked the last calendar year that the S&P GSCI Total Return Index exceeded the spot index (20.72% versus 10.8%; see chart 11).

Chart 11



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