S&P CAPITAL IQ

Lookout Report
from Global Markets Intelligence

S&P 500 Earnings Fall Short Of Double-Digit Growth In Fourth-Quarter 2011, But We'll Take It

Michael Thompson
Managing Director
Global Markets Intelligence
(1) 212-438-3480
michael_thompson@spcapitaliq.com

Robert Keiser
Vice President
Global Markets Intelligence
(1) 212-438-3540
robert_keiser@standardandpoors.com

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.

It seems that the ongoing fourth-quarter 2011 earnings season will ultimately break the string of the eight consecutive quarters of double-digit earnings growth that lasted from fourth-quarter 2009 to third-quarter 2011. Fourth-quarter growth for S&P 500 corporations is currently tracking at 8.26%, with 18% of companies yet to release results. Analysts last expected double-digit fourth-quarter earnings growth on Oct. 31, 2011 (10.07%), according to the S&P Capital IQ consensus, before lowering expectations to just 5.15% as recently as Jan. 23, 2012. Within the context of a U.S. economy that was perceived to be slipping into recession at the start of the second half of last year, we consider 8% growth quite respectable as well as considerably healthier than the 5% growth that analysts previously expected. At the start of the reporting season, the 8% growth rate was the figure we had in the back of our mind for gauging the health of fourth-quarter 2011 results, despite the prospective end of double-digit growth.

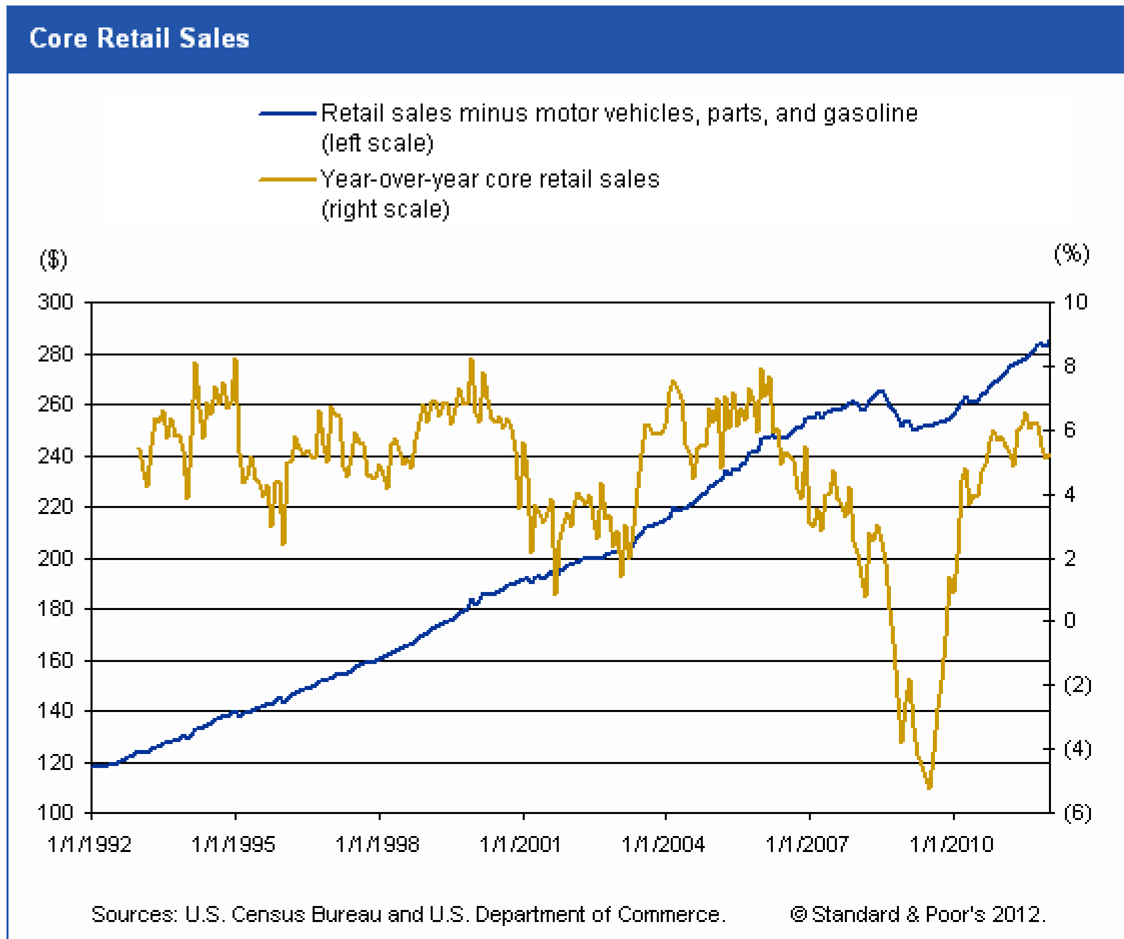
The Global Markets Intelligence (GMI) research team generally views quarterly earnings reporting cycles as periodic report cards that grade the ability of corporations to execute their business plans under existing global macroeconomic conditions. The extent that corporations are able to produce respectable current earnings relative to market expectations helps investors gauge if corporations are likely to meet, or preferably beat, expectations for future earnings. At face value, predicated on the ability of the U.S. economy to avoid recession, the 8% fourth-quarter 2011 S&P 500 earnings growth rate suggests to us that companies should be able to achieve the low- to mid-single-digit growth expected over the first three quarters of 2012, and possibly the return to double-digit earnings growth forecast for the fourth quarter, according to analysts surveyed by S&P Capital IQ.

While tracking U.S. economic expansion, GMI Research will continue to monitor monthly U.S. retail sales, which just eclipsed the $400 billion level for the first time in January and produced the eighth consecutive month of record sales. Our reading of core retail sales, which we define as sales excluding light vehicles and gasoline, continues to grow at the 5% to 6% year-over-year pace that has been in place since September 2010 (see chart 1). As long as core U.S. retail sales continue to grow at a minimum 4% to 6% pace, we anticipate that U.S. economic expansion will remain on track, enabling S&P 500 corporations to meet or beat consensus forward-looking earnings expectations.

February 17, 2012

These assumptions, in our view, are entirely consistent with the approximate 1,450 to 1,500 year-end target for the S&P 500 Index, outlined later in this publication by Howard Silverblatt, our colleague from S&P Indices.

Chart 1



Inside This Issue:

Macroeconomic Overview

Within the context of a U.S. economy that was perceived to be slipping into recession at the start of the second half of last year, we consider 8% growth for fourth-quarter 2011 quite respectable as well as considerably healthier than the 5% growth that analysts previously expected. At the start of the reporting season, the 8% growth rate was the figure we had in the back of our mind for gauging the health of fourth-quarter results, despite the cessation of double-digit growth.

Economic And Market Outlook: North American And European Earnings

Although it seems North American earnings growth will not reach double digits, the rate for the quarter has continually improved in the final weeks of earnings season and is now at 8.26%, the highest it's been since December 16 (8.11%). Meanwhile, analysts continued to lower estimates for European companies over the two-week period.

S&P Index Commentary: The S&P 500 Index Will Inevitably Reach 1,500--The Question Is When?

We anticipate that increasing consumer and investor confidence will drive some degree of P/E expansion from the current 14.0x trailing level as long as U.S. economic activity remains robust. Companies continue to earn record profits, investors now just need to believe that this trend will continue for the foreseeable future.

Leveraged Commentary And Data: The Gift That Keeps On Giving: A Hot Market Spurs A Renewed Dividend Push

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Market Derived Signal Commentary: Retail Sales Should Provide Support To Consumer Discretionary Credit Default Swaps

Consumer discretionary CDS spreads, as reflected in the S&P/ISDA CDS U.S. Consumer Discretionary Select 20 Index (Select 20), widened Tuesday, despite a U.S. retail sales report that was anything but grim. However, economists polled by Reuters expected a slightly better result.

Capital Market Commentary: The Escalating Equity Market Buoys New IPOs

As the S&P 500 Index has risen by 7.49% so far this year, the typical IPO priced on major U.S. exchanges, excluding closed-end funds, has climbed 15.8%, according to S&P Capital IQ data. Of the 15 IPOs priced in the U.S. so far in 2012, 11 have appreciated from their respective offer price.

S&P Index Commodity Commentary: Energy Risk Fears Accelerate

Early 2012 optimism has been replaced a bit by fear--fear of spiking petroleum prices. The January recovery in industrial metals prices has begun to fade as petroleum prices have rallied, reintroducing geopolitical risk back into the market.

Solutions Architect Market Commentary: U.S. Macroeconomic Fundamentals

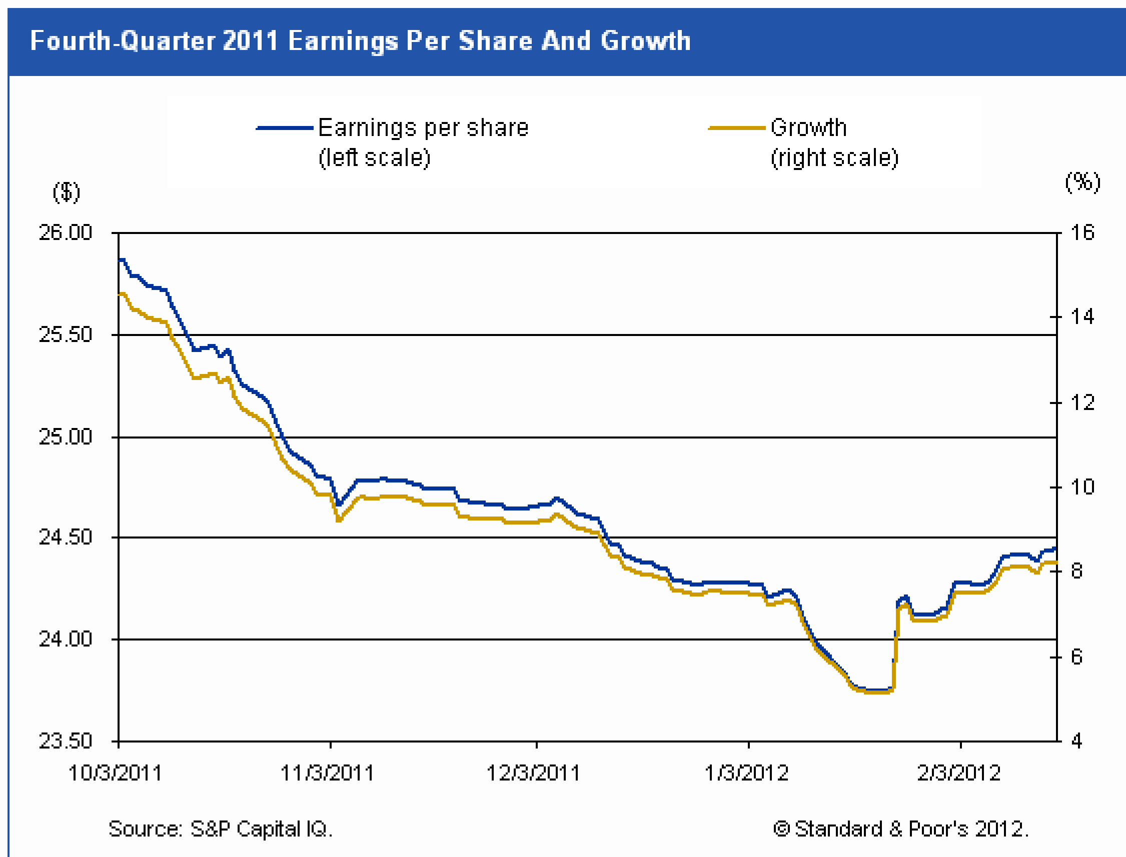
As U.S. economic prospects continue to brighten, at least relative to the pervasive gloom that dominated financial markets this past summer, the improving rate of U.S. light vehicle unit sales continues to underpin this growing optimism. Unit vehicle sales increased to 14.13 million in January 2012 from 13.48 million in December 2011, the healthiest sales rate since May 2008, excluding cash-for-clunkers.

Economic And Market Outlook: North American And European Earnings

North American

What a difference a couple of weeks make. In the final weeks of fourth-quarter earnings season, 410 companies in the S&P 500 Index have reported results, which are now looking a bit better than they were at the time of our last report. The estimated growth rate for the quarter has continually improved and is now at 8.26%, the highest it's been since Dec. 15 (8.34%). The information technology and industrials sectors continue to add to the forecast, with growth expectations of 16.95% and 13.36%, respectively. The telecommunications (negative 20.7%), materials (negative 14%), and utilities (negative 2%) sectors are continuing to detract from growth. Earnings-per-share estimates for the index dipped below the $24 mark during the third week of January, but now stand at $24.45 (see chart 2).

Chart 2



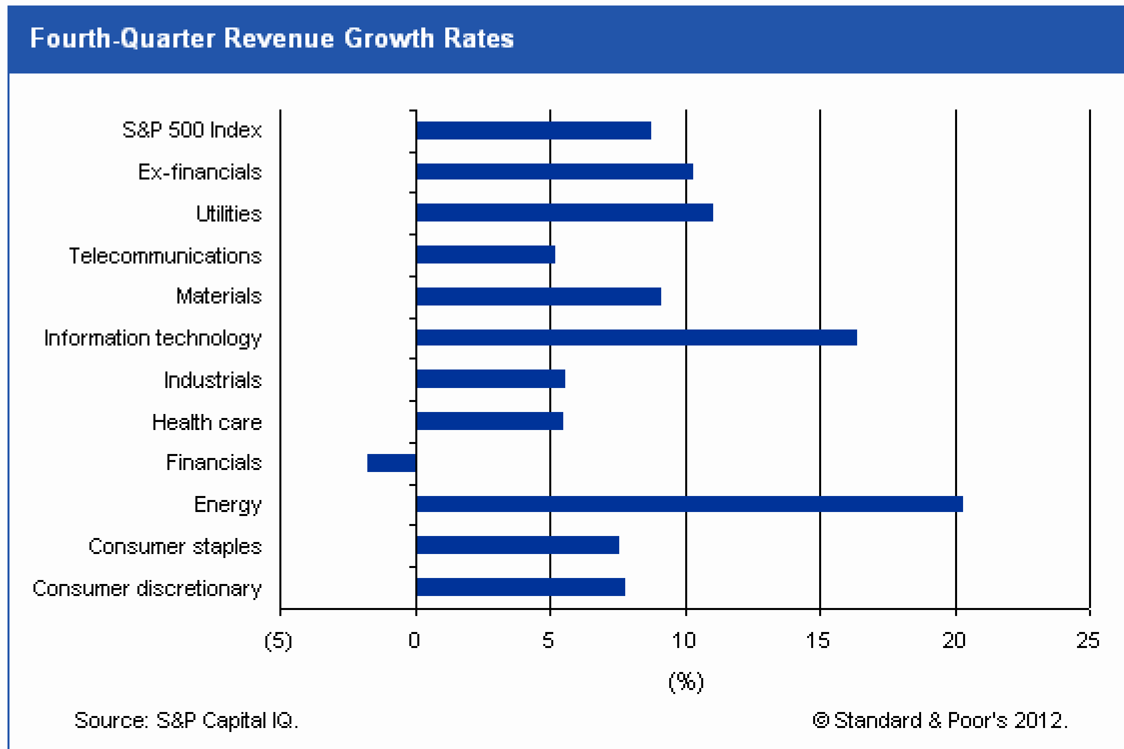
Just two weeks ago, we were also concerned with what was a very low beat rate of 57% at the time. Had the season ended at 57%, it would have marked the lowest beat rate since 2001. Due to strong positive surprises from the likes of Prudential Financial Inc., Lorillard Inc., and Pitney Bowes Inc., among others, the beat rate is now at 60%, only modestly lower than the long-term average of 62%. Companies within the information technology (70.31%) and industrials (67.31%) sectors are currently posting the most positive surprises, while the utilities (44.44%) and telecommunications (40%) sectors are showing the lowest beat rates. It's important to note, however that while these latter two sectors have the least amount of companies beating estimates, they also have the least amount of companies reporting at this point, with only 56% of telecom companies and 55% of utilities companies reporting results. Next week will provide a better picture of where these two sectors will end the season as a majority of companies within them are scheduled to release results.

Company issued guidance has also improved in recent weeks. On Feb. 3, the negative-to-positive (N/P) ratio was a very high 2.7, meaning for every 2.7 companies that reported negative guidance, only one reported positive guidance. Since then, nine companies have issued guidance for the first quarter. Of those, six have been positive (Applied Materials Inc., Cerner Corp., CVS Caremark Corp., Dean Foods Co., Equifax Inc., and FMC Corp.), while only two have been negative (Ingersoll Rand Public Ltd Co. and Life Technologies Corp.) and one has been in-line (Cognizant Technology Solutions Corp.), increasing the count to 54 negative and 26 positive. This gives us an N/P ratio of 2.1, still slightly higher than the long-term average of 2.0, but much improved.

Revenue growth expectations have increased slightly to 8.8% from 8.4% on Feb. 3 (see chart 3). Now that the gap

between earnings and revenue growth expectations has narrowed, concerns about margin compression have mostly dissipated. Leading revenue growth estimates are the energy (20.31%) and information technology (16.40%) sectors.

Chart 3

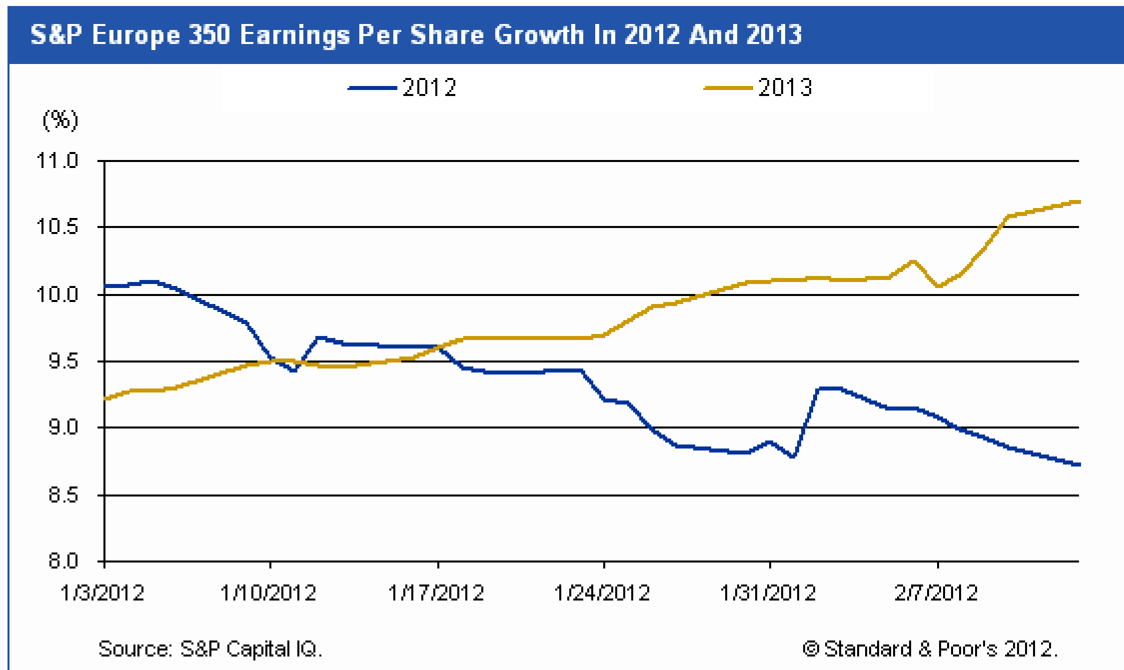


The only figures that haven't improved since our last Lookout Report are those for 2012. Although it might be too early for analysts to accurately predict the first half of 2012, estimates have remained low--1.15% for the first quarter and 1.85% for the second quarter. While many anticipate U.S. economic expansion will slow during the first two quarters of the year, analysts expect earnings growth to mount a comeback in the second half, with growth forecast at 5.8% for the third quarter and 15.5% for the fourth quarter.

Europe

Over the two weeks ended Feb. 10, analysts lowered their 2012 and 2013 earnings growth forecasts by 1.2% and 0.7%, respectively. While analysts still forecast reasonably high earnings growth of more than 9% for both 2012 and 2013, the GMI research team noted divergence in the direction of growth rates for the two years (see chart 4). Analysts are lowering their earnings forecasts at a much quicker pace for 2012 than for 2013. Since the start of the year, 2012 earnings forecasts have decreased by 3.6%, while 2013 forecasts have decreased by 2.4%. As a result, the earnings growth rate for S&P Europe 350 corporations in 2013 has increased and is now in double-digits.

Chart 4



This divergence in 2012 and 2013 growth rates could mean that analysts are too uncertain about 2013 to adjust their forecasts, or that they actually expect the economy and businesses to improve next year. We believe that it is more the latter, as large companies normally give guidance at least two years ahead.

In 2012, the financials, industrials, and utilities sectors still dominate earnings growth expectations, at 25%, 13%, and 10%, respectively.

After analysts substantially lowered expectations for the information technology sector in the last couple of weeks, the sector's earnings are now expected to fall 14% this year. We believe that in addition to being cyclical, the information technology sector currently experiences tough global competition between the companies within the sector. We believe this magnifies the negative macroeconomic effect on European information technology corporations this year. The health care and materials sectors also lag in 2012, with almost no earnings growth expected for health care and just 2% for materials.

The information technology sector is the exceptional earnings growth leader for 2013. However, this is mainly because of favorable comparisons with 2012.

Analysts expect the cyclical sectors to return to robust growth despite lower earnings. Growth forecasts for 2013 for the index have increased nearly 1% over the past month, suggesting analysts are optimistic about the future performance of European corporations despite expected recession this year.

With analysts expecting the European economy to stabilize in 2013, we do not see prominent 2013 sector laggards. The most subdued earnings growth (for the telecommunications sector) is still relatively high, at 4%.

Contact Information: Christine Short, Senior Manager—Global Markets Intelligence, Christine_Short@standardandpoors.com

Victoria Chernykh, Director—Global Markets Intelligence, Victoria_Chernykh@standardandpoors.com

S&P Index Commentary: The S&P 500 Index Will Inevitably Reach 1,500--The Question Is When?

Keeping in mind that the purpose of the S&P 500 Index is to emulate the U.S. large-cap market, not to beat it, we present a scenario to gain insights into where the S&P 500 Index might be trading one year from today.

Applying one year S&P 500 constituent share price targets provided by S&P Capital IQ equity analysts within a framework of the current index weighting for each company, the S&P 500 Index is forecast to be trading at 1,496 in February 2013. This represents a potential 10.7% gain for the index and a 12.9% total return to investors including dividends. The annual compounded rate for the S&P 500 Index since 1926 is 9.86%. By sector, energy appears headed for a 19.8% gain, financials are expected to yield 6.7% (versus an 18.4% decline in 2011), and utilities, which outperformed the nine other sectors in 2011 (14.8%) is expected to rise just 2.5%.

Investors, in our opinion, are also hoping for medium-term price-to-earnings (P/E) ratio expansion. The trailing P/E for the S&P 500 Index is currently a historically low 14x, compared with the 15-year average of over 20.2x. If the S&P 500 Index were trading at a 20.2x multiple today, the index would be trading at a lofty 1,957. Even a one point increase in the current P/E would add 100 points to the index.

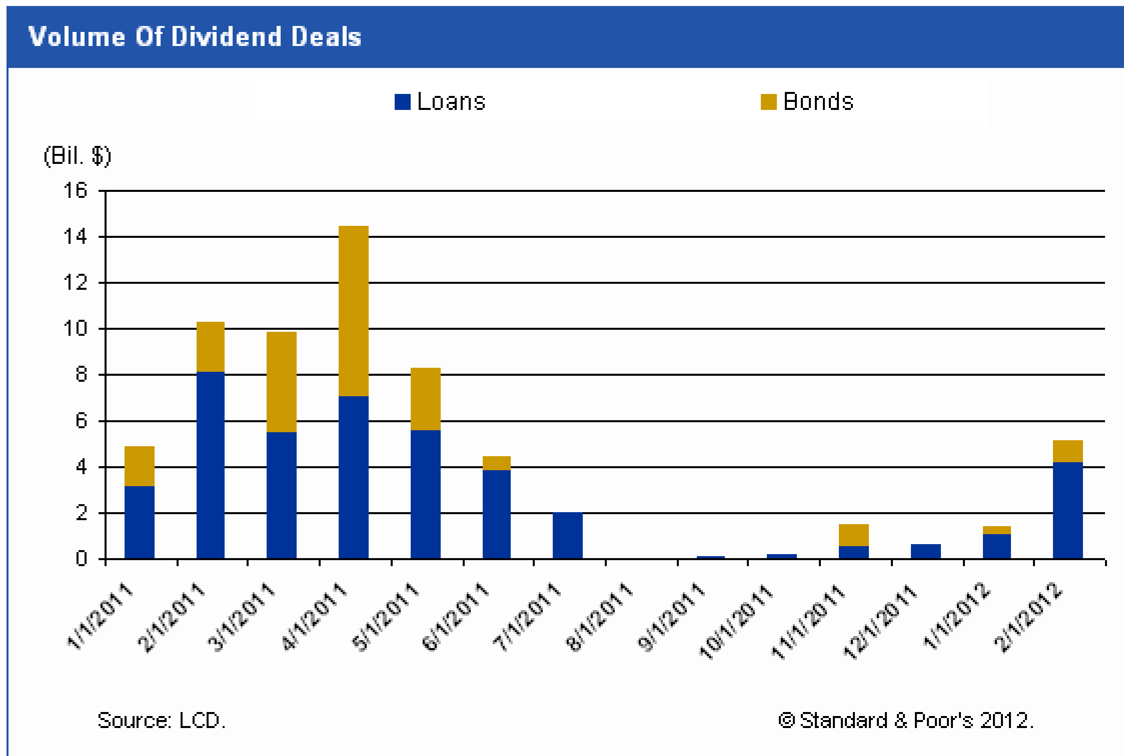
In a purely hypothetical exercise, we calculate what a one-point P/E expansion would mean for the market in conjunction with a conservative 5% reduction in S&P Capital IQ equity analysts' expected 2012 earnings. Even after compensating for this haircut to forecasted earnings, which would still result in record levels, the S&P 500 Index would reach a record high of 1,582 in February 2013, rising 17.1% for the year and eclipsing the all-time high of 1,565 set on Oct. 9, 2007. We anticipate that increasing consumer and investor confidence will drive some degree of P/E expansion from the current 14.0x trailing level as long as U.S. economic activity remains robust. Companies continue to earn record profits, investors now just need to believe that this trend will continue for the foreseeable future.

Contact Information: Howard Silverblatt, Senior Index Analyst—S&P Indices,
Howard_Silverblatt@standardandpoors.com

Leveraged Commentary And Data: The Gift That Keeps On Giving: A Hot Market Spurs A Renewed Dividend Push

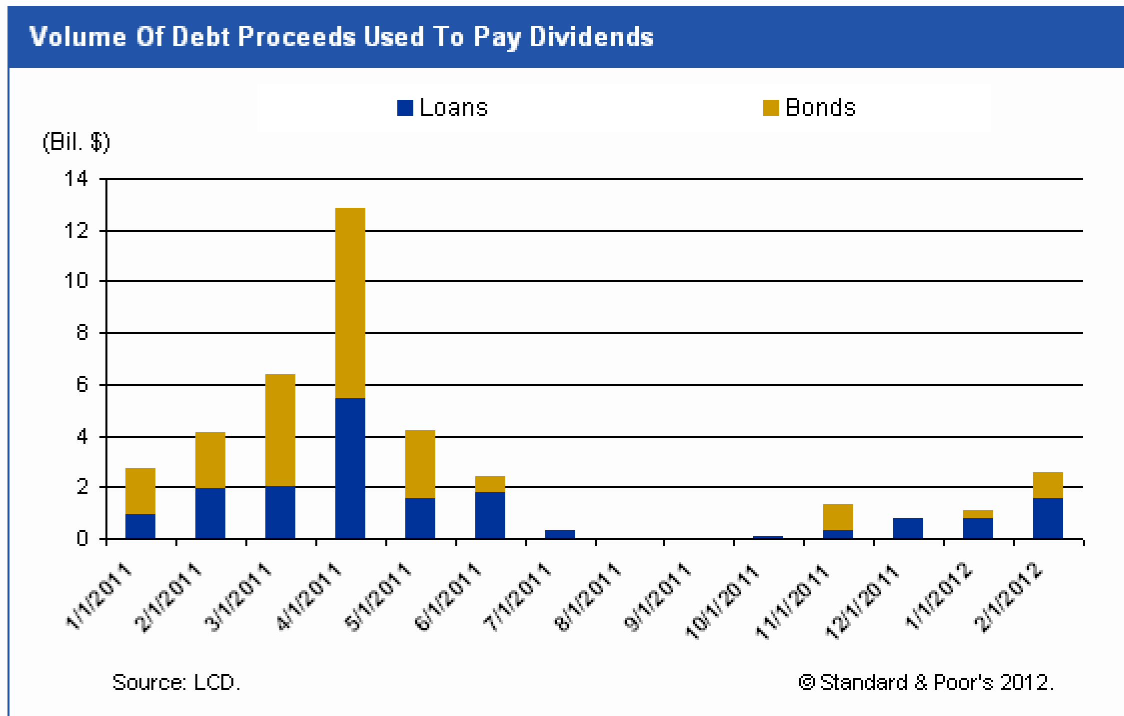
Strong conditions in leveraged finance have sparked a nascent revival in dividend financing, propelled by such deals as Asurion Corp., Cequel, Focus Brands Inc., and Bragg Communications Inc.. In all, issuers launched $5.1 billion of such paper during the first 10 days of February, including $4.1 billion of loans and $1 billion of bonds (see chart 5). That is the largest figure since last May.

Chart 5



Of course, dividend-related loans are usually structured as part of a larger refinancing. Paring the figures down to just proceeds used to pay dividends, February's total is $2.6 billion, also a seven-month high, versus $1.1 billion in January (see chart 6).

Chart 6



In all, then, issuers have launched $6.5 billion of dividend-related loans and bonds in the year to date. That is more than the entire second half of 2011, when choppy--and often challenging--conditions kept the total to $4.4 billion.

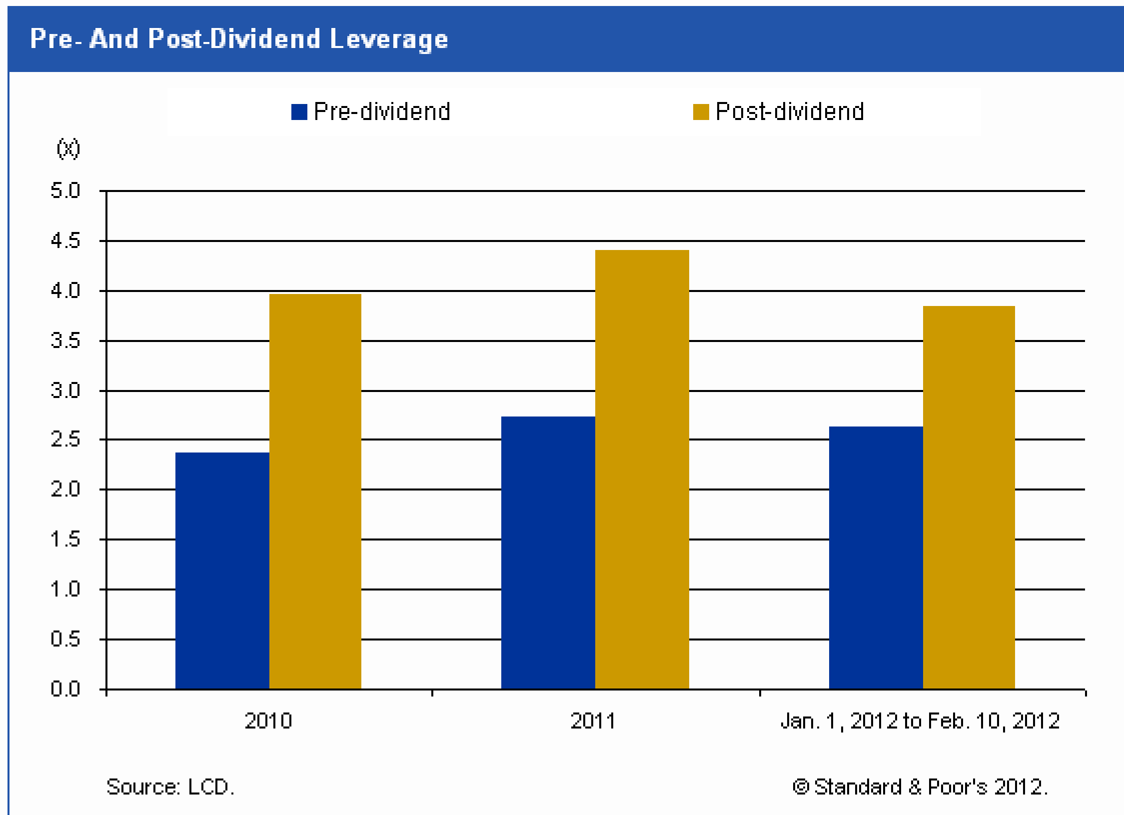
Still, dividend activity remains inside the $8.7 billion monthly average of the liquidity-drenched opening half of 2011. And, in fact, Attachmate Corp.'s recently pulled transaction shows that investors have limits and aren't willing to go along with the most aggressive dividend proposals.

The planned dividend was large--Attachmate was seeking to pay out $609 million, comprising the owners' entire cash equity position plus an estimated $40 million to $50 million additional payout. Although the absolute increase in leverage wasn't outsized--a one-turn increase, to 3.7x--investors were wary about the business trend line. Indeed, the recent Attachmate-Novell merger represents cost-cutting play as opposed to the equity-friendly growth story pitched by Asurion. Existing lenders were in a power position, having to amend to approve the incremental debt used to fund the dividend, and second-lien investors in particular were concerned about the additional first-lien debt coming in ahead of them. And some investors felt that the corresponding leverage would be uncomfortably close to Attachmate's total valuation in a downside scenario.

Asurion, too, was adding just a turn of leverage. One significant difference was that leverage would be 5x, versus a concurrent equity investment that values the issuer at an 11x multiple.

As these deals illustrate, lenders are financing dividends at conservative terms. The average 2012-model deal, for instance, added 1.2 turns of leverage, to 3.8x, versus 1.7 turns, to 4.4x, in 2011 (see chart 7).

Chart 7



While the data are too thin to provide an average for 2012 deal flow, these dividend trades are compelling indeed for private equity firms, which, on average, have recaptured 64% of their original contributed capital for deals executed since 2011. Here, too, the recent deals punch below their weight compared with the historical average of 96%.

Looking ahead, arrangers expect dividend activity to continue apace as long as technical conditions are supportive and the macro picture remains stable. Certainly, there remain plenty of re-leveraging candidates. Of all S&P/LSTA Index issuers that file publicly, 22% had leverage inside of 3x as of the third quarter, according to S&P Capital IQ data.

Contact Information: Steve Miller, Managing Director—Leveraged Commentary & Data,
Steven_Miller@standardandpoors.com

Market Derived Signal Commentary: Retail Sales Should Provide Support To Consumer Discretionary Credit Default Swaps

Consumer discretionary credit default swap (CDS) spreads, as reflected in the S&P/ISDA CDS U.S. Consumer Discretionary Select 20 Index (Select 20), widened Tuesday, despite a U.S. retail sales report that was anything but grim. However, economists polled by Reuters expected a slightly better result.

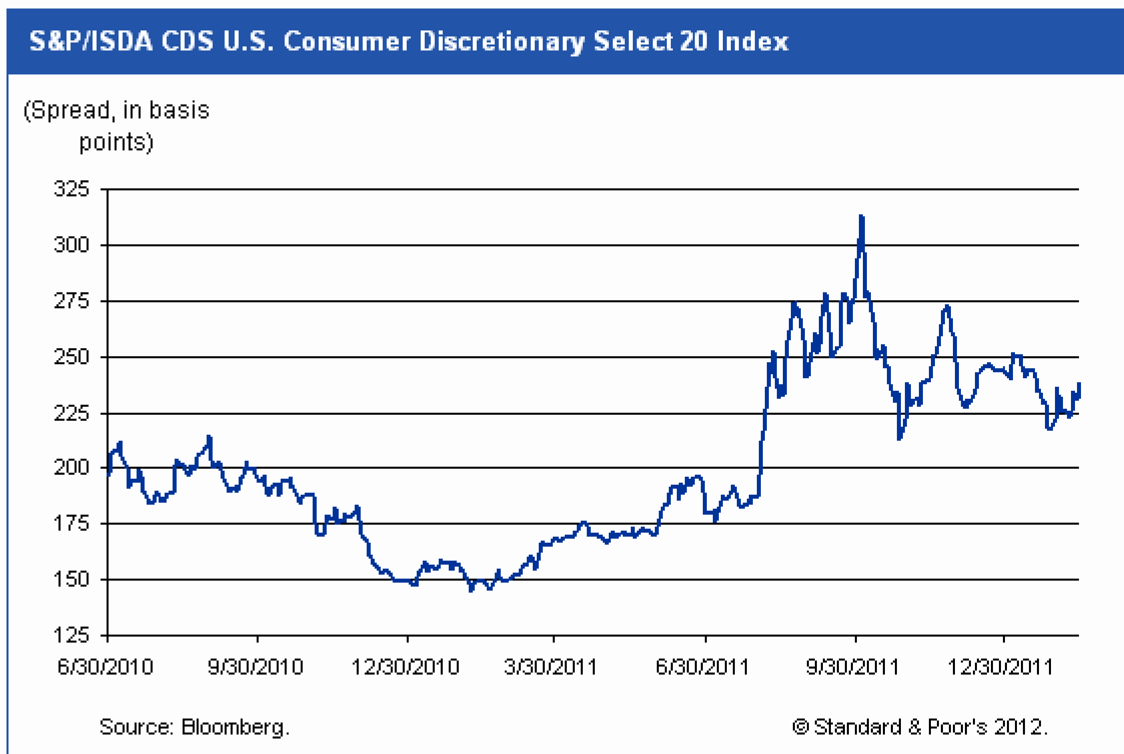
U.S. retail sales rose to a record $401.4 billion in January, up 0.4% from December (less than the forecast 0.7% rise) and 5.8% from January 2011, providing further evidence--along with modest improvement in unemployment--that the nation's economy continues to strengthen. Dining and drinking establishments as well as garden equipment and supplies dealers showed particular strength, with sales up 8.2% and 8.1%, respectively, from January 2011, according to the U.S Commerce Department. The GMI research team thinks if retail sales continue to increase by a minimum of 4%, the

economic growth we expect will continue.

We wanted to find out if the credit market's reaction to the retail sales data indicated a potential widening trend, so we looked more closely at the Select 20 and among the spreads for individual consumer discretionary corporate CDS, compiled by CMA DataVision.

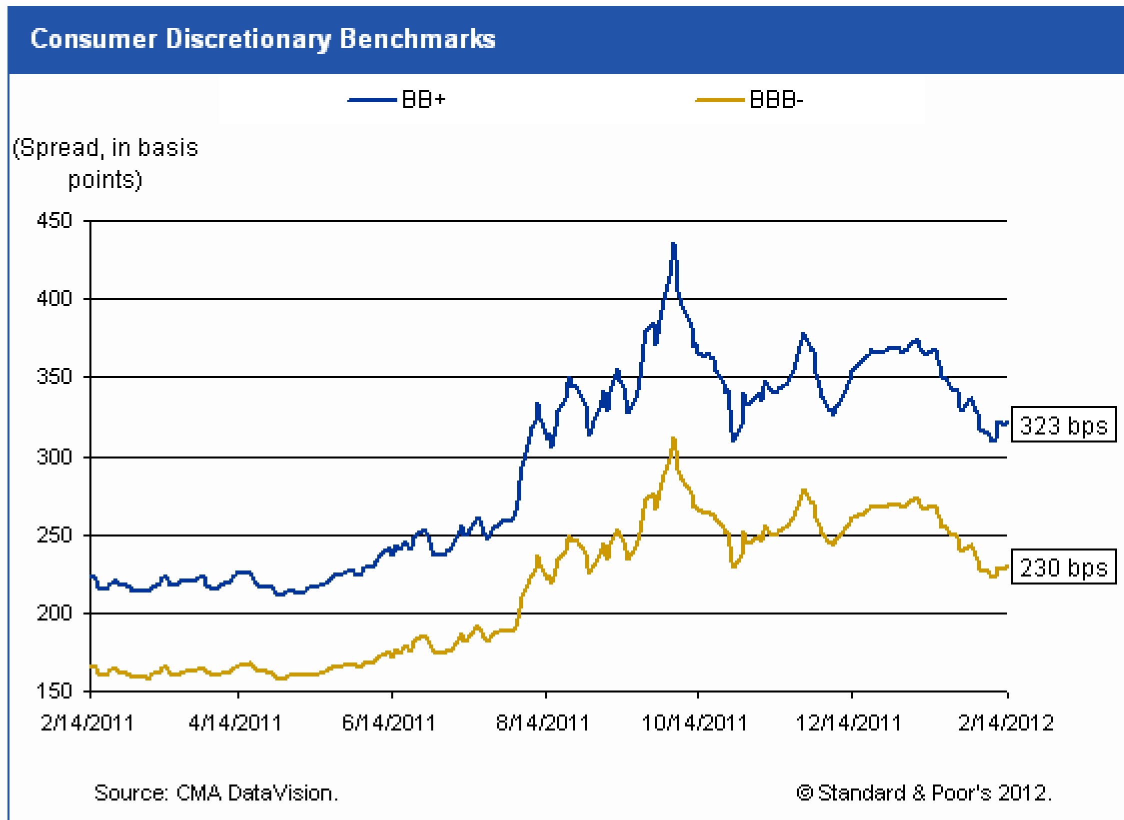
Although the Select 20 widened to 238 basis points (bps) on Tuesday from 231 bps on Monday and 224 bps a week ago, the index is 75 bps tight of the all-time high of 313 bps set on Oct. 4, 2011. It is trading 8 bps wide of the 230 bps for the 'BBB-' consumer discretionary ratings benchmark (see chart 8).

Chart 8



Individual U.S. corporate consumer discretionary spreads widened 3% Tuesday to an average of 330 bps, but they tightened 11% over the past month (see chart 9). In comparison, the spread on the 'BB+' consumer discretionary benchmark is only 7 bps tighter at 323 bps, so the average CDS is trending toward the investment-grade level, rather than away from it, but the average spread still needs to tighten by 100 bps to move out of speculative-grade territory.

Chart 9



Aside from the retail sales report, the GMI research team thinks there are other positive indicators in the consumer discretionary sector. Analysts polled by S&P Capital IQ expect the sector to report 9.59% earnings growth for 2012, the most significant increase behind the 10.81% growth forecast for the industrials sector. Year to date through Feb. 14, the sector is outpacing the S&P 500 Index by 8.1% to 5.8%. As such, we don't foresee an extended widening trend at this time.

Contact Information: Lisa Sanders, Director—Global Markets Intelligence, Lisa_Sanders@standardandpoors.com

Capital Market Commentary: The Escalating Equity Market Buoys New IPOs

IPOs

If a rising tides lifts all ships, can an escalating equity market buoy newly public companies? That appears to be the case for the crop of initial public offerings (IPOs) priced in early 2012. As the S&P 500 Index has risen by 7.49% so far this year, the typical IPO priced on major U.S. exchanges this year, excluding closed-end funds, has climbed 15.8%, according S&P Capital IQ data. Of the 15 IPOs priced in the U.S. this year, 11 have gained ground from their respective offer price, led by a 69.7% increase in the shares of application software company Guidewire Software Inc. and followed by a 58.2% gain the common shares of casino and gaming operator Caesars Entertainment Corp.

Although these seem like positive signs for the IPO market, filings perhaps suggest otherwise. Since Facebook's filing on Feb. 1, just five companies have filed plans to issue common shares to the public, compared to 15 companies that registered IPOs between Feb. 1 and Feb. 14 of last year.

Table 1

IPOs Priced In U.S. Market In 2012

Effective date	Target/Issuer	Value (mil. $)*	Price per share ($)	Day close price ($)	Change (%)
1/24/2012	Guidewire Software Inc.	115.1	13	22.06	69.7
2/7/2012	Caesars Entertainment Corp.	16.3	9	14.24	58.2
2/1/2012	Greenway Medical Technologies Inc.	66.7	10	13.80	38.0
2/9/2012	GSE Holdings Inc.	63.0	9	11.74	30.4
2/7/2012	Roundy's Parent Co. Inc.	163.1	8.5	10.22	20.2
2/7/2012	EPAM Systems Inc.	72.0	12	13.96	16.3
2/8/2012	FX Alliance Inc.	62.4	12	13.33	11.1
2/10/2012	HomeStreet Inc.	80.0	44	48.50	10.2
1/26/2012	Verastem Inc.	55.0	10	10.90	9.0
2/9/2012	Synacor Inc.	34.1	5	5.05	1.0
1/31/2012	U.S. Silica Holdings Inc.	200.0	17	17.05	0.3
2/2/2012	Cempra Inc.	50.4	6	6.00	0.0
2/1/2012	MRC Energy Co.	160.0	12	11.75	(2.1)
1/18/2012	Renewable Energy Group Inc.	72.0	10	9.26	(7.4)
2/1/2012	AVG Technologies N.V.	128.0	16	13.14	(17.9)
	Average				15.8

*Total transaction values. Source: S&P Capital IQ.

M&A

As U.S. merger and acquisition (M&A) activity in early 2012 remains tepid, transactions have yet to exceed the $10 billion mark. So far this year, the largest announced U.S. M&A deal is Roche Holding AG's unsolicited $6.2 billion bid for Illumina Inc. The last time there was an announced U.S. M&A deal of more than $10 billion was on Nov. 21, 2011, when Gilead Sciences Inc. signed a definitive agreement to acquire Pharmasset Inc. for $11 billion. That currently represents an 85-day period with no deals of more than $10 billion, marking the longest stretch since early 2011, when Duke Energy Corp. announced its $26.6 billion purchase of Progress Energy Inc. 163 days after Sanofi-Aventis bid $21.5 billion for Genzyme Corp. The ongoing interval between the last big M&A deal and the next may be causing some anxiety in some corner of the capital markets sector (see table 2).

Table 2

Time Lapse Between Recent $10 Billion-Plus U.S. M&A Announcements

Announced date	Days since prior $10 billion-plus deal	Target/Issuer	Status	Value (mil. $)*	Buyers/Investors
7/29/2010	99	Genzyme Corp.	Closed	21,501.5	Sanofi
1/8/2011	163	Progress Energy Inc.	Announced	26,627.3	Duke Energy Corp.
2/15/2011	38	NYSE Euronext Inc.	Cancelled	12,657.2	Deutsche Boerse AG
3/13/2011	26	The Lubrizol Corp.	Closed	10,367.2	Berkshire Hathaway Inc.
3/20/2011	7	T-Mobile USA Inc.	Cancelled	39,000.0	AT&T Inc.
4/1/2011	12	NYSE Euronext Inc.	Cancelled	13,587.6	Nasdaq OMX Group Inc.; Intercontinental Exchange Inc.
4/26/2011	25	Synthes Inc.	Announced	21,534.6	Johnson & Johnson
4/28/2011	2	Constellation Energy Group Inc.	Announced	12,701.9	Exelon Corp.
7/14/2011	77	Petrohawk Energy Corp.	Closed	15,753.6	BHP Billiton Ltd.
7/14/2011	0	The Clorox Co.	Cancelled	12,006.5	Icahn Enterprises L.P.

Table 2

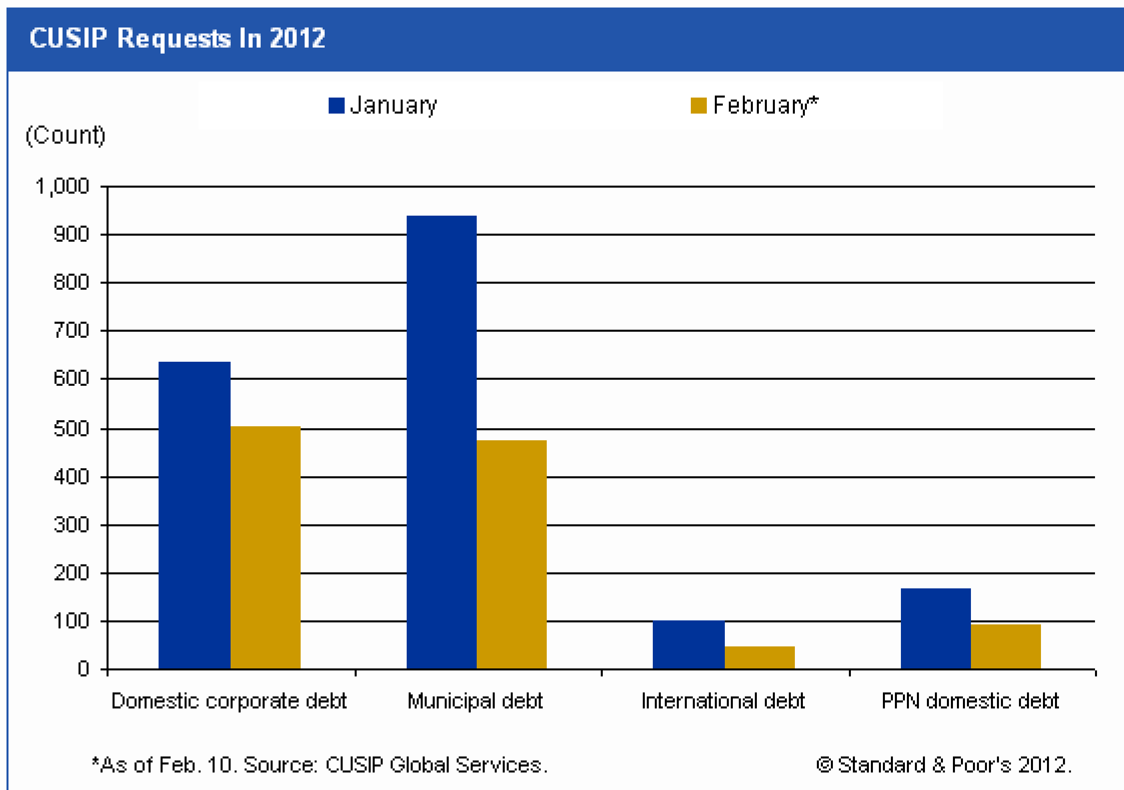
Time Lapse Between Recent $10 Billion-Plus U.S. M&A Announcements (cont.)					
7/20/2011	6	Medco Health Solutions Inc.	Announced	33,564.7	Express Scripts Inc.
8/10/2011	21	U.S. Card and Retail Services Business	Announced	32,190.0	Capital One Financial Corp.
8/15/2011	5	Motorola Mobility Holdings Inc.	Announced	12,033.2	Google Inc.
9/21/2011	37	Goodrich Corp.	Announced	18,641.1	United Technologies Corp.
10/16/2011	25	El Paso Corp.	Announced	35,658.2	Kinder Morgan Inc.
11/21/2011	36	Pharmasset Inc.	Closed	11,011.7	Gilead Sciences Inc.

*Total transaction value. Source: S&P Capital IQ.

Debt

Following January's security identifier request results for various debt instruments, there are some reasons for optimism, in our opinion. Specifically, domestic corporate debt CUSIP requests have already reached 503 in the first 10 days of February, according to CUSIP Global Services (see chart 10). Extrapolating those requests, it is not unreasonable to assume identifier orders for this security class to break the 1,000 mark for the first time since last September. Likewise, municipal debt identifier requests have already exceeded more than half of the January total, putting this security class on track for its first 1,000 month of the year.

Chart 10



Contact Information: Rich Peterson, Director—Global Markets Intelligence, Rich_Peterson@standardandpoors.com

S&P Index Commodity Commentary: Energy Risk Fears Accelerate

The S&P GSCI Index ended Feb. 16 with a year-to-date gain of 5.24% led by the rally in petroleum prices, which have sparked fears of a detrimental effect on consumer spending and GDP. The most consumer sensitive commodity--unleaded gas--is leading S&P GSCI Energy Index gains on the back of increasing tensions in Iran, despite declining demand in the U.S. and contributing to disappointing retail sales.

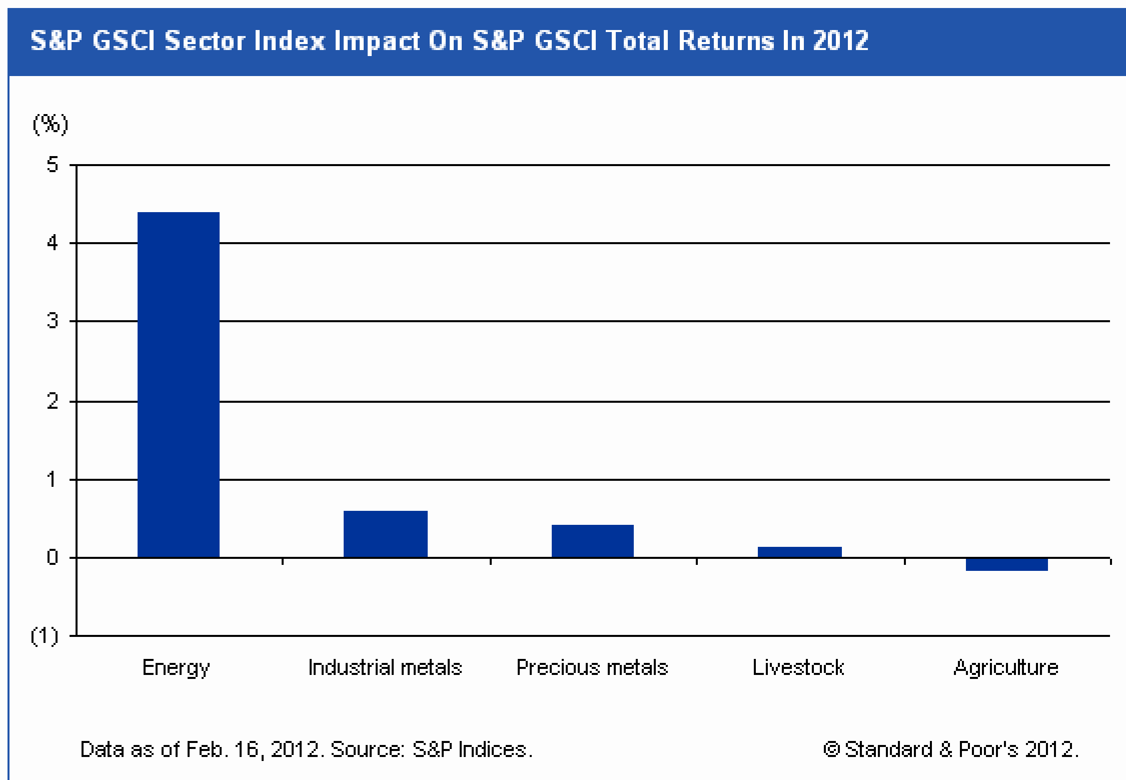
Unleaded Gas Spike Hurting Consumers

U.S. January advanced retail sales were reported at 0.4%, which was one half of the expected increase and one half of the increase from January 2011. Year to date, the S&P GSCI Unleaded Gas Index has been the best-performing single-commodity energy index, with a gain of 13.57%, just behind the S&P GSCI Brent Crude increase of 11.22%. There is no commodity that is more "in-the-face" of consumers, and that can negatively affect consumer spending and sentiment more than spiking unleaded gas prices. Some analysts cited higher unleaded gas prices for lower-than-expected January retail sales.

Petroleum Catching up to Industrial Metals

Due to the greater global world production significance and subsequent higher index weight, the energy sector has had the greatest positive effect on the S&P GSCI as of Feb. 16, accounting for more than 4% of the S&P GSCI total returns (see chart 11). Reflecting early 2012 optimism, the industrial metals sector sprinted ahead in January to lead all sector index gains but has since pulled back to hold only a slight lead on petroleum, as measured by the S&P GSCI Industrial Metals Index year-to-date increase of 8.42%, compared with an increase of 6.99% for the S&P GSCI Petroleum Index. The 2012 single-commodity leading loser--natural gas--has helped to temper overall energy index gains as reflected by the 19.05% decline in the S&P GSCI Natural Gas Index. Agriculture has subtracted from S&P GSCI Index returns in 2012 as measured by the year-to-date decline of 1.37% in the S&P GSCI Agriculture Index on the back of declines in wheat and corn prices.

Chart 11



Contact Information: Mike McGlone, Senior Director, Commodities—S&P Indices,
Mike_McGlone@standardandpoors.com

Solutions Architect Market Commentary: U.S. Macroeconomic Fundamentals

As U.S. economic prospects continue to brighten, at least relative to the pervasive gloom that dominated financial markets this past summer, the improving rate of U.S. light vehicle unit sales continues to underpin this growing optimism. Unit vehicle sales increased to 14.13 million in January 2012 from 13.48 million in December 2011, the healthiest sales rate seen since May 2008, excluding cash-for-clunkers.

The fact that auto sales are positively correlated with underlying business cycles should surprise no one, but we were still curious about the historical strength of this seemingly logical relationship. We investigated median correlations between total sales for eight Global Industry Classification Standard (GICS) sectors and 23 U.S. macroeconomic factors over the past 10 years. Selected macroeconomic factors such as M2 money supply, trade balance, and unemployment have historically shown negative correlations with all sectors. Factors such as GDP (nominal), personal income, and personal outlays have demonstrated a positive correlation with all sectors with regard to what we have observed.

We discovered that the consumer discretionary sector has the strongest average correlation, at 26.7%, whereas the health care sector has the weakest average correlation for all U.S. macroeconomic factors, at 18.6%. Within the consumer discretionary sector, we found that the auto components industry has the most sensitivity to--and most correlation with--U.S. macroeconomic factors. The auto components industry had the largest standard deviation (48.10%) and the largest range (140.6%) of correlations with manufacturing capacity utilization, at 73.4% and negative 67.2% versus M2 money supply (see table 3).

Table 3

Auto Components' Median Correlations To U.S. Macroeconomic Factors

(%)

Case Shiller 10	42.48	M2 - 4wk Avg	(67.22)
Case Shiller 20	41.80	New one family homes	43.14
Capacity Utiliz MFG	73.40	Nonfarm payroll	48.79
Conventional 30-year loan rates	35.60	PCE core	(50.08)
CPI	45.84	Personal income	52.77
Durable goods	70.39	Personal outlays	59.91
Existing home sales		Retail sales	71.65
GDP nominal	68.31	Trade balance	(59.84)
Industrial Production Index	70.36	Unemployment rate	(64.19)
ISM Non-Mfg	52.87	Unit vehicle sales	72.44
ISM Purchasing Manager	51.31		

This table was created using the if Analytics correlation database. Correlations are between total sales (revenue) and U.S. macroeconomic factors over the most-recent 10-year period. Only correlations with a 90% or greater significance were included. Table elements where there were less than 15 companies with correlation coefficients of 90% or greater significance were excluded. For example, the durable goods for diversified consumer services left blank.

Narrowing in on the auto components industry, we have determined the three macroeconomic factors that have been most negatively and positively correlated with total sales for auto components companies and identified the top-correlated companies for each factor. Trade balance, the unemployment rate, and M2 money supply have been on average highly negatively correlated among the auto components companies, whereas manufacturing capacity utilization, unit vehicle sales, and retail sales have been on average highly positively correlated.

Table 4 displays the five most positively correlated companies among the selected macroeconomic factors with total sales. Cooper-Standard Holdings Inc. stands out in that it is represented in manufacturing capacity utilization, unit vehicle sales, and retail sales, with correlations of 83%, 91%, and 85%, respectively.

Table 5 displays the five most negatively correlated companies among the selected macroeconomic factors with total sales. Tower International Inc. and Cooper-Standard Holdings stand out in that they are represented in each macroeconomic factor. For trade balance, the unemployment rate, and M2 money supply, Tower International had correlations of negative 77%, negative 71%, and negative 85%, respectively; and Cooper-Standard Holdings had correlations of negative 84%, negative 72%, and negative 88%.

Table 4

Top 5 Positively Correlated Companies Within The Auto Components Industry

(%)

--Capacity utiliz MFG--		--Unit vehicle sales--		--Retail sales--	
Stoneridge Inc.	85	Tower International Inc.	93	Tower International Inc.	85
Johnson Controls Inc.	83	Cooper-Standard Holdings Inc.	91	Cooper-Standard Holdings Inc.	85
Federal-Mogul Corp.	83	Johnson Controls Inc.	83	Federal-Mogul Corp.	83
Cooper-Standard Holdings Inc.	83	TRW Automotive Holdings	81	Linamar Corp.	82
Tenneco Inc.	82	Tenneco Inc.	80	Borgwarner Inc.	81
Average	83		86		83

Source: if Analytics.

Table 5

Top 5 Negatively Correlated Companies Within The Auto Components Industry

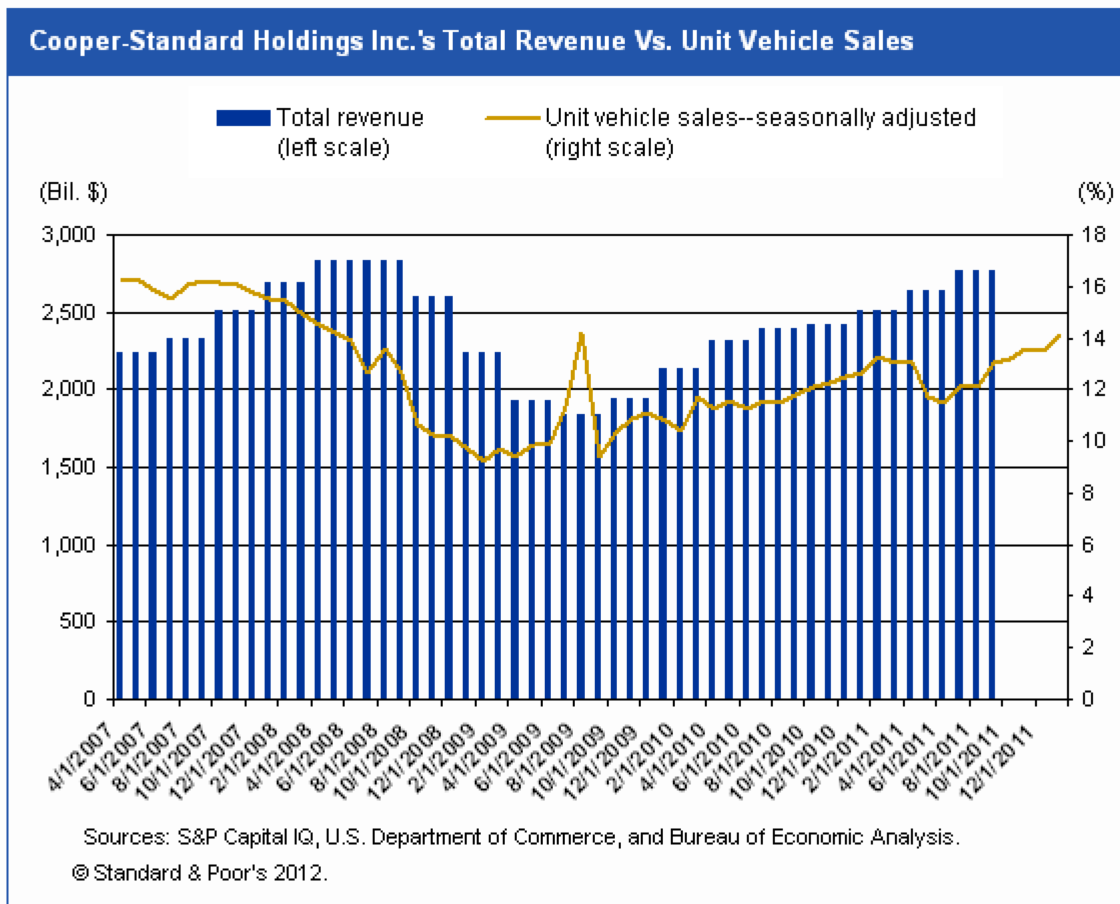
(%)

--Trade balance--		--Unemployment rate--		--M2; four-week average--	
Cooper-Standard Holdings Inc.	(84)	Linamar Corp.	(75)	Cooper-Standard Holdings Inc.	(88)
Modine Manufacturing	(78)	Johnson Controls Inc.	(73)	Tower International Inc.	(85)
Tower International Inc.	(77)	Cooper-Standard Holdings Inc.	(72)	Borgwarner Inc.	(80)
Linamar Corp.	(75)	Tower International Inc.	(71)	Linamar Corp.	(79)
Magna International	(70)	Federal-Mogul Corp.	(70)	Lear Corp.	(77)
Average	(77)		(72)		(82)

Source: if Analytics.

Total sales for Cooper-Standard Holdings, an auto components company, has been highly positively correlated with retail sales (91%), and as such might see significant moves if this trend continues (see chart 12).

Chart 12



This commentary summarizes findings that we thoroughly discuss in our recent article, "Solutions Exchange Product Spotlight: The Potential Effect Of U.S. Macroeconomic Factors On Company Fundamentals," published Feb. 14, 2012, on RatingsDirect. The full article highlights ways that we believe investors can use a comprehensive correlation data set to identify potential trends in aggregate sector data and to identify stand-out companies.

Contact Information: Thomas Yagel, Solutions Architect—S&P Capital IQ's Solutions Architects, Thomas_Yagel@standardandpoors.com

Contact Information: Evan Shenkin, Solutions Architect—S&P Capital IQ's Solutions Architects, Evan_Shenkin@standardandpoors.com

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