S&P CAPITAL IQ

Lookout Report
from Global Markets Intelligence

U.S. Fiscal Cliff Drama Continues: Act I (Taxes) Transitions To Act II (Spending) Following A Brief Intermission

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

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

The self-imposed fiscal cliff was supposed to be a hard and fast deadline, intended to force policymakers to address both the revenue and expenditure sides of unsustainable U.S. deficits and debt accumulation. But with government unable to move toward any form of compromise until the absolute last possible moment, our elected officials only managed to address the tax policy side of this problem, postponing the more challenging spending side of this debate for at least another two months. If there is any semblance of a silver lining, Act I has played out essentially in line with our expectations that the revised tax code would maintain most of the existing tax code for household incomes up to roughly the $500,000 level.

Global Markets Intelligence (GMI) Research is disappointed that Congress could not develop a comprehensive, balanced, and bipartisan deficit reduction deal in a more conclusive manner. We have previously introduced the notion of a "stimulus dividend" in the form of increased business confidence and optimism that would follow a well thought out and credible resolution of the fiscal cliff conundrum (see "Lookout Report: Going Over The Fiscal Cliff Could Easily Tip The U.S. Economy Into Recession And Negative Earnings Growth," published Dec. 14, 2012, on the Global Credit Portal). While such a scenario is still plausible, it is also safe to say that we are not off to the best start imaginable in this process. We agree with Standard & Poor's Ratings Services' sentiment that lawmakers' latest efforts leave the impression "that Washington's governance and policymaking has become less stable, less effective, and less predictable."

Tax hikes and Federal spending cuts constitute fiscal tightening measures, so GMI Research will continue to wait for evidence that Congress and the White House will be able to at least partially offset lost fiscal accommodation by reaching a credible agreement and delivering on expectations for the stimulus dividend. But considering that Act I of the fiscal drama has fallen short of what we considered to be reasonable expectations, and that the upcoming political battle over spending cuts and entitlement reform will prove to be much more challenging than tax negotiations proved to be, our confidence is waning.

We continue to believe that Washington, D.C. needs to reach a credible compromise solution that successfully dissolves the fog of uncertainty and indecision that has hampered GDP growth this past year and since the start of this recovery in 2009. Rising business confidence and optimism alongside continued extreme monetary accommodation from the Federal Reserve represents the best hope for a healthy U.S. economy and respectable corporate earnings growth in 2013. GMI Research begins 2013 with a baseline forecast that includes a 10% gain for the stock market in the coming year, taking the S&P 500 Index to approximately 1,600 by year-end. Rather than predict how the second act of the fiscal cliff drama will play out in the months to come, we will continue to closely follow certain key economic data to gauge how households and business react to socioeconomic political theater and fiscal restraint. For better or for worse, once we are able to put the fiscal cliff and debt ceiling negotiations behind us, it will once again be up to "Helicopter" Ben Bernanke and the Federal Reserve to keep the U.S. housing recovery moving forward as an engine of economic growth. If there is to be a stimulus dividend after the fog of uncertainty dissipates, it should be very evident in a declining U.S. unemployment rate, increased home sales and housing starts, as well as indications that S&P 500 corporations will report earnings growth that is closer to the 10% expected for calendar-year 2013 as opposed to the dismal 3.4% growth produced in 2012, according to the latest reading of the S&P Capital IQ consensus.

Inside This Issue:

Macroeconomic Overview

The self-imposed fiscal cliff was supposed to be a hard and fast deadline, intended to force policymakers to address both the revenue and expenditure sides of unsustainable U.S. deficits and debt accumulation. But with government unable to move toward any form of compromise until the absolute last possible moment, our elected officials only managed to address the tax policy side of this problem, postponing the more challenging spending side of this debate for at least another two months.

Economic And Market Outlook: North American And European Earnings

On Tuesday, Jan. 8, the fourth-quarter earnings season for S&P 500 companies will begin, in its usual fashion, with Alcoa Inc. releasing results. Unlike the second and third quarters of 2012, analysts expect positive earnings growth as we enter the fourth quarter. While this is reassuring considering the weak earnings figures in 2012, the fourth-quarter 2012 number has fallen precipitously in recent weeks

S&P Index Commentary: First Day Trade

Wednesday's 2.54% gain in the S&P 500 was the index's best performance since Dec. 20, 2011, when it rose by 2.98%, and the best opening day since 2009, when the index began the year with a 3.16% gain (see table). The best single-day performance in 2012 was on June 29, 2012, when the index added 2.49%. 2013 marked the fifth consecutive year that the index opened in positive territory--a first--and it was the 30th opening with a gain of at least 1%.

Leveraged Commentary And Data: Leveraged Loans Return 0.79% In December, 9.66% In 2012

Propelled by muscular technical conditions and positive investor sentiment across the capital markets, the S&P/LSTA Loan Index posted its best performance in three months in December, returning 0.79%, up from 0.31% in November. The large loans that comprise the S&P/LSTA Loan 100 Index fared even better, returning 1.08% during the final frame of 2012, up from 0.07% in November.

Municipal Bond Commentary: Municipal Bonds Outperformed Gold In 2012

Investment-grade municipal bonds, as tracked by the S&P National AMT-Free Municipal Bond Index, returned 6.52% in 2012 while gold, as tracked by the S&P GSCI Gold TR Index, returned 6.02%. Flight-to-quality investors helped maintain the supply/demand imbalance throughout the year by driving municipal bond mutual fund cash inflows. The result was reflected in investment-grade yields falling by about 78 basis points (bps) in the 10-year range, or the "belly of the curve."

Market Derived Signal Commentary: The Consumer Discretionary Sector Is Poised For Improvement

GMI Research thinks the average spread for consumer discretionary companies will potentially contract modestly from the current level since the U.S. fiscal cliff crisis has now been averted. Over the week ended Jan. 2, the average spread had already tightened 3.6%. Positive fourth-quarter earnings reports and an optimistic outlook for 2013 from these companies would go a long way in further restoring the credit market's confidence in the sector.

Capital Market Commentary: IPOs, M&A, And Debt

Sometimes, bottom fishing can be a lucrative endeavor, when unwanted or discarded items later become valuable. In the initial public offering (IPO) market, that has been the case in some instances as seen below in the 2012 performance of 2011's laggards. Using S&P Capital IQ data, we uncovered the worst performers among 2011's U.S. IPOs and examined their 2012 performance. Of the 10 largest percentage decliners in 2011, six showed gains last year while four continued to lose ground.

S&P Index Commodity Commentary: Agriculture And Precious Metals Were The Best Performers In 2012--But The Worst In December

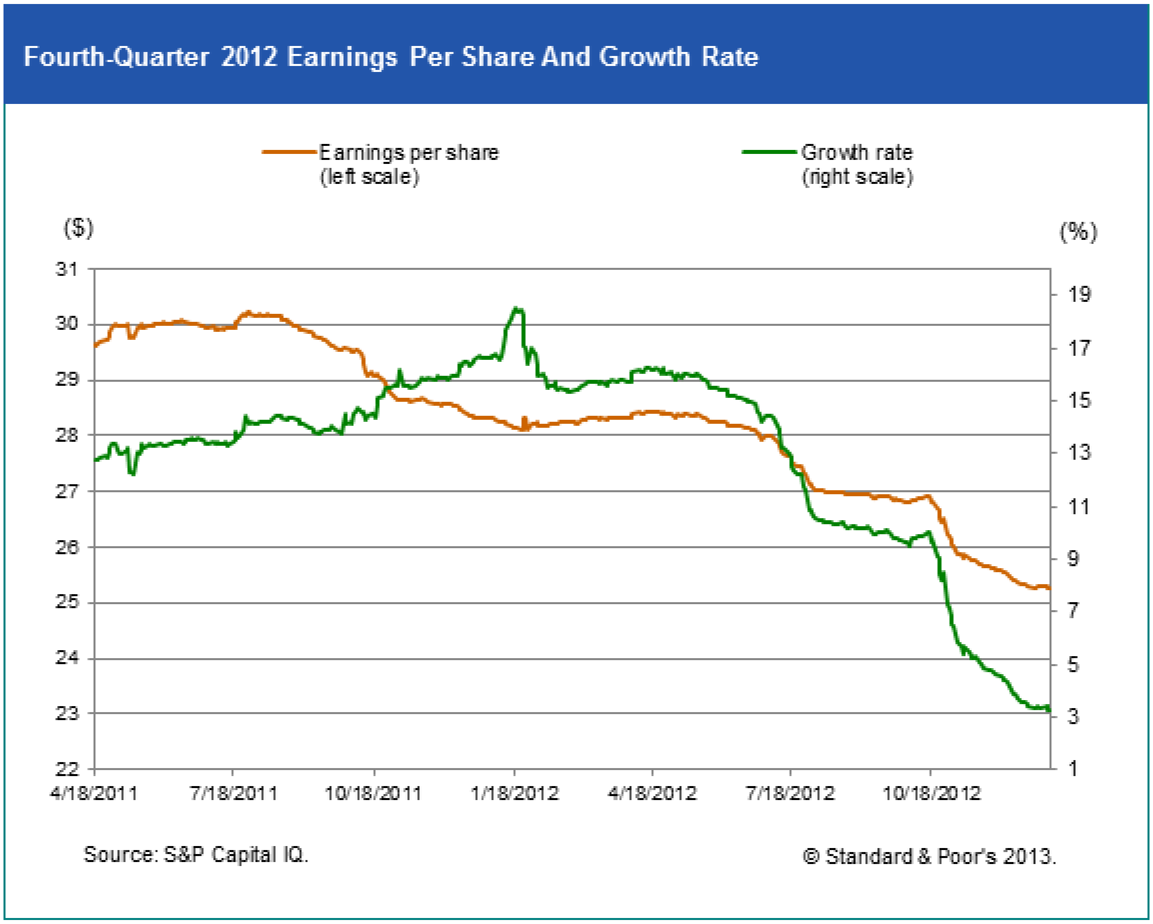
The S&P GSCI ended 2012 with a slight gain, as weakness in the energy sector offset strength in most other commodities. Rapidly increasing North American energy production pressured energy prices, while agriculture and metals prices appreciated. WTI crude oil was the year's main dud, and the grains were the studs.

Economic And Market Outlook: North American And European Earnings

North America

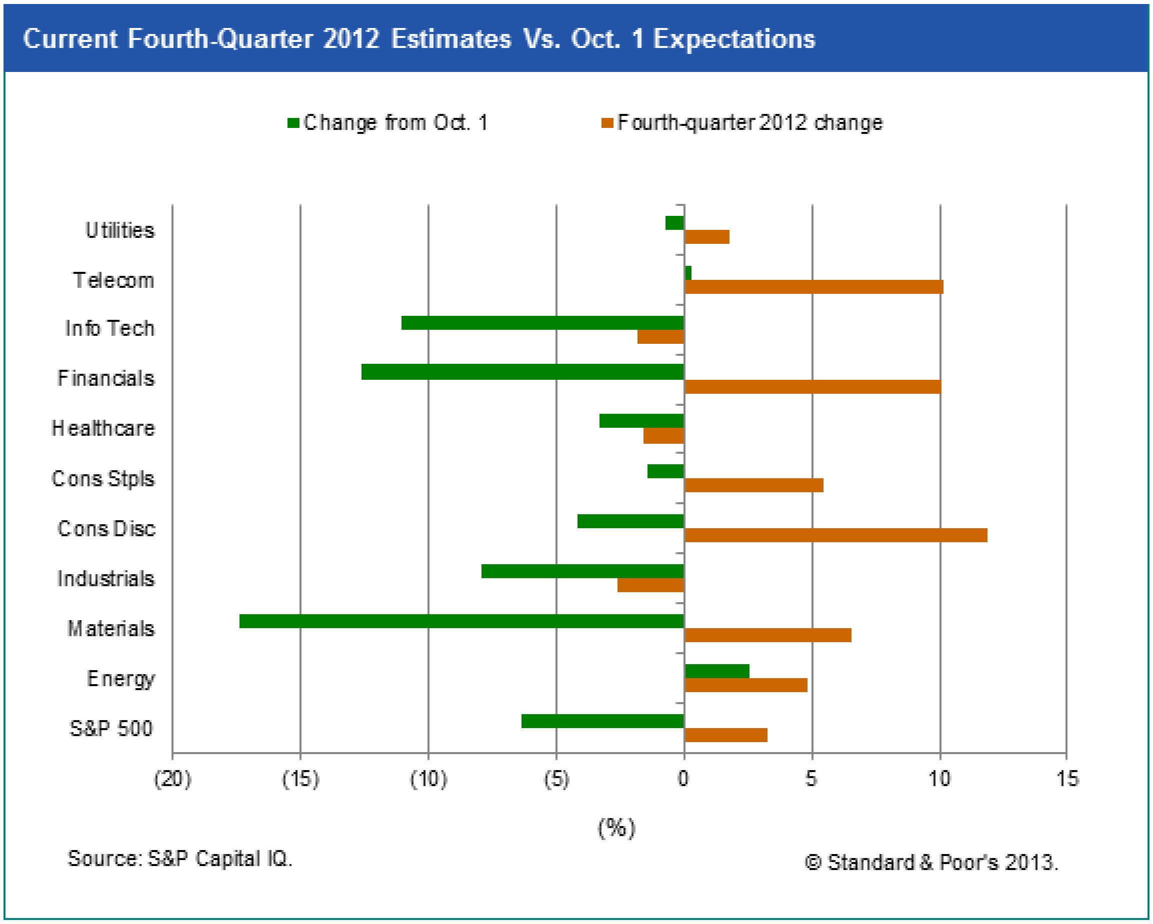
On Tuesday, Jan. 8, the fourth-quarter earnings season for S&P 500 companies will begin, in its usual fashion, with Alcoa Inc. releasing results. Unlike the second and third quarters of 2012, analysts expect positive earnings growth as we enter the fourth quarter. While this is reassuring considering the weak earnings figures in 2012, the fourth-quarter 2012 number has fallen precipitously in recent weeks. Analysts currently anticipate profit growth will be 3.28%, about a third of the 9.6% predicted at the beginning of the quarter on Oct. 1. In any case, this is still the strongest expectation since the first quarter of 2012 (see chart 1).

Chart 1



Surprisingly, it is not the commodities-based sectors, such as materials and energy, that are dragging the index lower in the fourth quarter. Instead, analysts expect the industrials (negative 2.58%) and information technology (negative 1.8%) sectors to be the biggest S&P 500 laggards this time around, two sectors that had very strong showings throughout 2012 (see chart 2). The industries responsible for the year-over-year decline within the information technology sector are semiconductors (negative 30.8%), office electronics (negative 10.7%), and computers and peripherals (negative 5.3%). Within semiconductors and semiconductor equipment, 11 of 17 companies are expected to report negative growth on a year-over-year basis, the biggest offenders being Teradyne Inc. (negative 95.8%) and Applied Materials Inc. (negative 80.5%). Dismal earnings predictions are linked to the demise of the personal computer, which continues to take its toll on the suppliers of commoditized chips. For that same reason, six of the eight computers and peripherals companies are expected to report declines in the fourth quarter. The worst earnings estimates are those of SanDisk Corp. (negative 43.2%), with makers of personal computers Dell Inc. (negative 24.4%) and Hewlett-Packard Co. (negative 23.5%) following. Even Apple Inc., a winner for the last several quarters, is expecting a decrease of 3.4%. Excluding Apple, earnings estimates for the information technology sector only improve slightly to negative 1.7%, and estimates for the S&P 500 improve to 3.5%.

Chart 2



On the upside, three sectors are expecting double-digit growth for the fourth quarter: consumer discretionary (11.8%), telecommunications (10.2%), and financials (10.1%). Typically, the fourth quarter is the strongest quarter for the consumer discretionary sector as retailers benefit from the holiday shopping season, although the data for 2012 is mixed. Retail sales have been sluggish over the last couple of months, and the MasterCard Spending Pulse report called 2012 the worst holiday shopping season since 2008, but strong same-store sales results for December suggest otherwise. In particular, specialty retailers (25.8%) and textiles, apparel, and luxury goods (18.9%) are at the top of the list for year-over-year growth expectations in the fourth quarter. Also, with a housing market that continues to recover, household durables are expected to be the strongest industry within the sector, with profit expectations of 55.3%. This is due to the likes of PulteGroup Inc. (675.1%) and Lennar Corp. (180.1%), both estimated to post triple-digit increases from the fourth quarter of 2011.

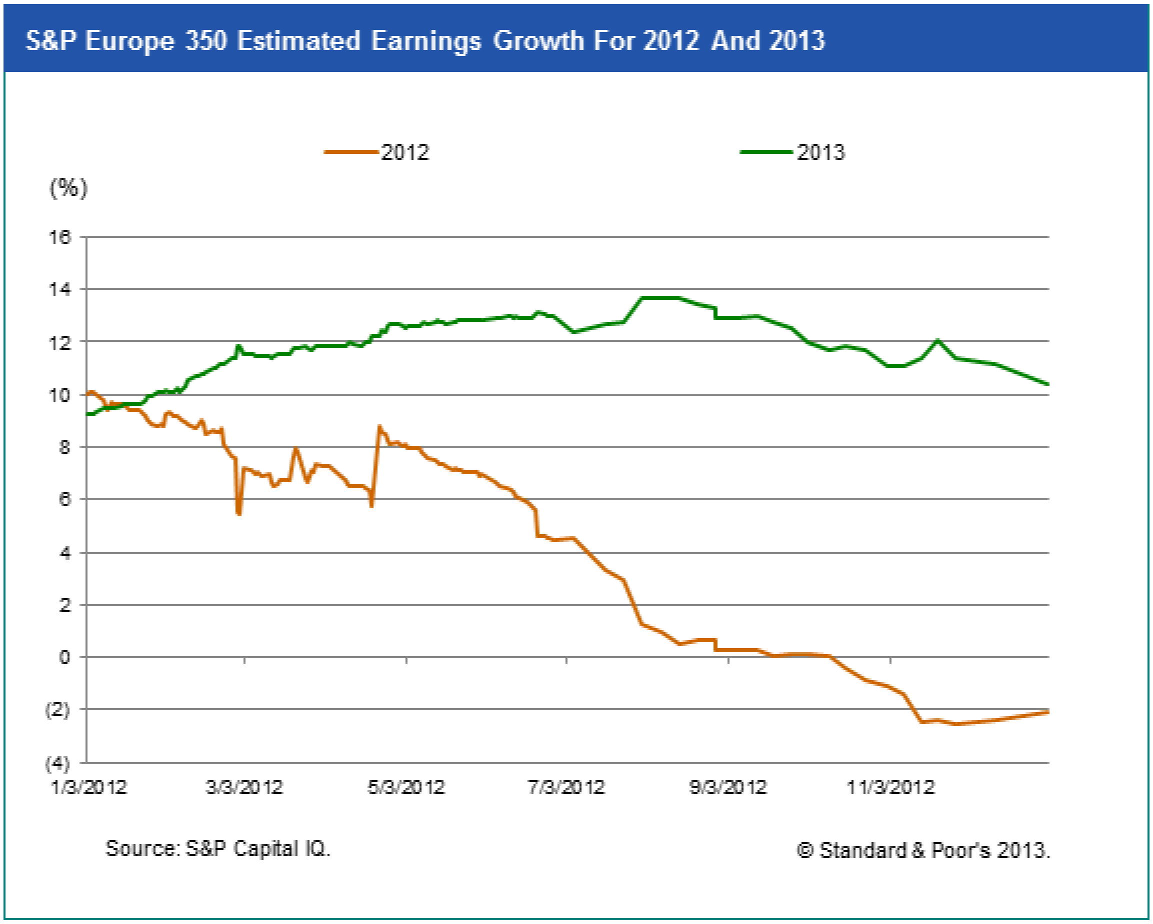
The fourth-quarter earnings season will be closely followed, and will no doubt set the pace for 2013 corporate profit expectations. The season will officially begin next week when Alcoa Inc., Monsanto Co., Apollo Group, Constellation Brands Inc., and Wells Fargo all release results.

Europe

Similar to the S&P 500, the fourth-quarter earnings season for companies within the S&P Europe 350 Index will begin in mid-January. The only difference between the two reporting seasons is that analysts do not expect all companies in the Europe 350 Index to report for the quarter, only those that currently have estimates, 203 companies (58%). The remainder will likely opt to report just second-half results or full-year results.

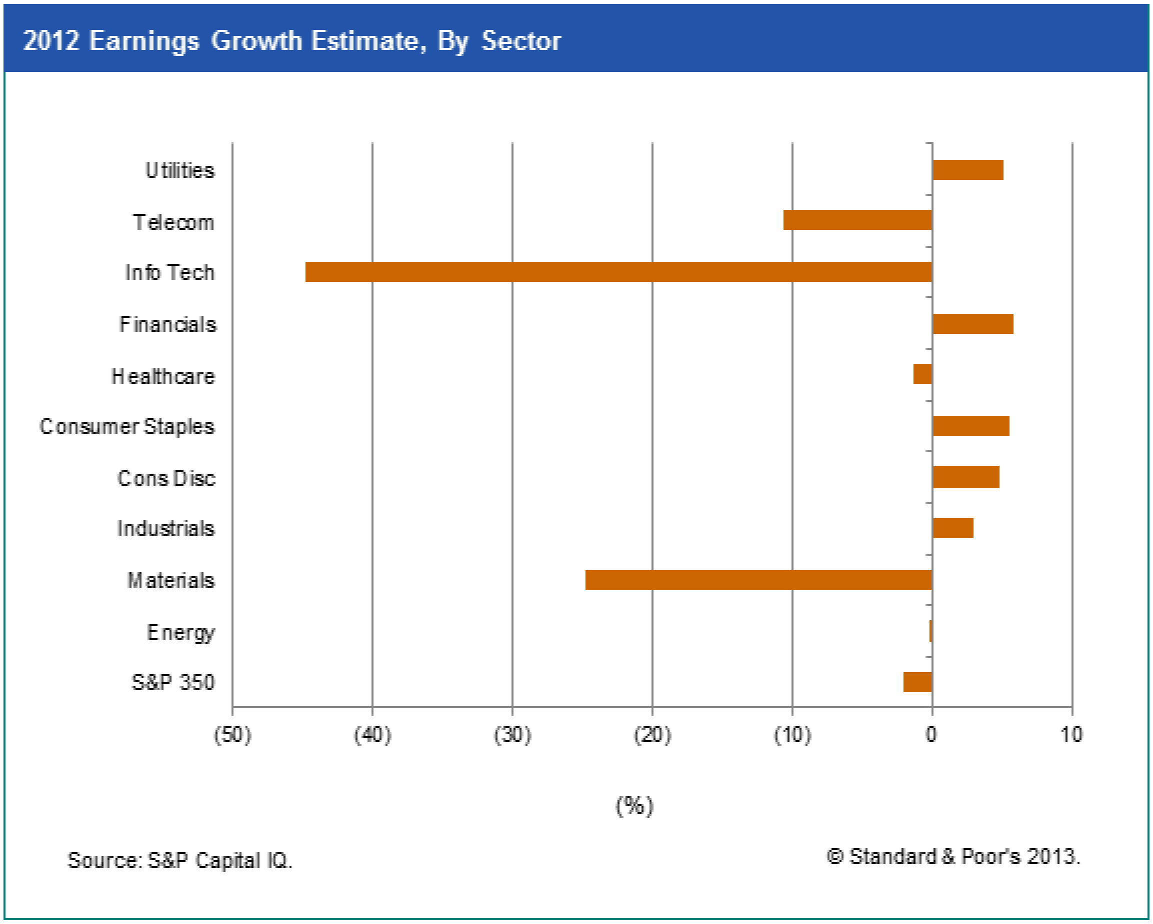
Calendar-year 2012 earnings estimates for the S&P Europe 350 Index seem to be recovering. Bottoming out at negative 2.53% during the week of Nov. 26, analysts now expect a stronger growth rate of negative 2.08% (see chart 3). This remains a concern, considering the weak year-ago figure of negative 1.89%. Many wonder if this will be Europe's second consecutive yearly decline in corporate profits. Five of the 10 sectors (energy, materials, health care, information technology, and telecommunication services) are expected to come in negative in 2012.

Chart 3



In the past two weeks, there has surprisingly been an improvement in earnings estimates for seven of the 10 sectors. Of the other three, the most significantly reduced estimates were for the financials sector, with growth estimates down 2.1% since the last edition of this report. This brings the estimate for financials down to 5.77%, the lowest level since we began collecting 2012 figures, but it is still the highest sector for the year (see chart 4). Beginning the week of Jan. 28, several of Europe's big banks will begin to report profit figures for the fourth quarter, second half of the year, and full year. The banks reporting that week include Deutsche Bank AG, Banco Santander SA, Banco Popular Espanol SA, Nordea Bank AB, Banco Bilbao Vizcaya Argentaria S.A., and Banco Espirito Santo. With the exception of Nordea Bank, each is expected to report year-over-year declines for 2012.

Chart 4



Estimated growth for 2013 still remains high at 10.4%, although that figure has steadily been decreasing in recent months. Analysts expect all sectors to report growth next year, with the exception of the telecommunication services (negative 1.4%) and utilities (negative 6.5%) sectors. The information technology (46.1%) and financials (25.5%) sectors are projected to lead growth next year. The earnings season for the S&P 350 will begin on Jan. 17 with reports from ASML Holdings and SGS SA.

Contact Information: Christine Short, Senior Manager—Global Market Intelligence, Christine_Short@spcapitaliq.com

S&P Index Commentary: First Day Trade

Wednesday's 2.54% gain in the S&P 500 was the index's best performance since Dec. 20, 2011, when it rose by 2.98%, and the best opening day since 2009, when the index began the year with a 3.16% gain (see table 1). The best single-day performance in 2012 was on June 29, 2012, when the index added 2.49%. 2013 marked the fifth consecutive year that the index opened in positive territory--a first--and it was the 30th opening with a gain of at least 1%.

Table 1

S&P 500 Performance

First trade of the year date	Close	Change (%)	January change (%)	February to December (%)	Full year (%)
01/02/2013	1462.42	2.54	N/A	N/A	N/A
01/03/2012	1277.06	1.55	4.36	9.05	13.41

Table 1

S&P 500 Performance (cont.)					
01/03/2011	1271.87	1.13	2.86	(2.86)	(0.00)
01/04/2010	1132.99	1.60	(3.70)	16.48	12.78
01/02/2009	931.80	3.16	(8.57)	32.02	23.45
01/02/2008	1447.16	(1.44)	(6.12)	(32.37)	(38.49)
01/03/2007	1416.60	(0.12)	1.41	2.12	3.53
01/03/2006	1268.80	1.64	2.55	11.07	13.62
01/03/2005	1202.08	(0.81)	(2.53)	5.53	3.00
01/02/2004	1108.48	(0.31)	1.73	7.27	8.99
01/02/2003	909.03	3.32	(2.74)	29.12	26.38
01/02/2002	1154.67	0.57	(1.56)	(21.81)	(23.37)
01/02/2001	1283.27	(2.80)	3.46	(16.51)	(13.04)
01/03/2000	1455.22	(0.95)	(5.09)	(5.05)	(10.14)
01/04/1999	1228.10	(0.09)	4.10	15.43	19.53
01/02/1998	975.04	0.48	1.02	25.65	26.67
01/02/1997	737.01	(0.50)	6.13	24.88	31.01
01/02/1996	620.73	0.78	3.26	17.00	20.26
01/03/1995	459.11	(0.03)	2.43	31.68	34.11
01/03/1994	465.44	(0.22)	3.25	(4.79)	(1.54)

Source: S&P Dow Jones Indices.

So what do we make of all this? Well, the year has moved in the same direction as the first day about half of the time. But as January goes, so, generally, goes the year. January has proved a worthy indicator in 61 of the last 84 years, or 72.6% of the time. January has closed higher 54 times since 1929 and those years have followed suit 43 times--79.6% consistency. The market has closed lower in January 30 times, and 18 of those years closed lower overall (60%).

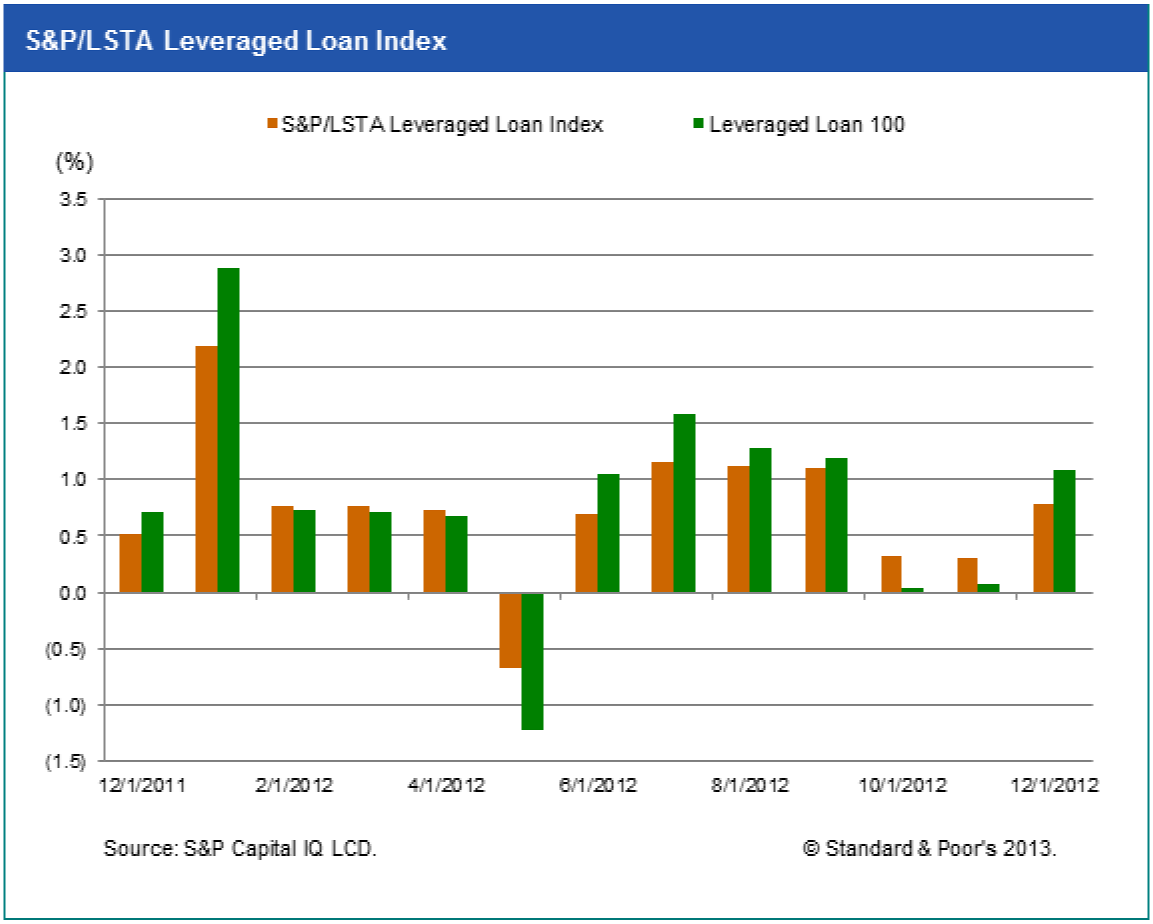
Wednesday's close of 1462.42 is 0.46% lower than where the index closed on Dec. 31, 2009. If an investor was in the S&P 500 for the only the first day of January (stock only, no dividends, interest, or taxes), they would have realized a gain of $3,610 today on an initial investment of $10,000 in 2000. On the other hand, an investor that had been in the index for the entire period would have lost $46 overall.

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

Leveraged Commentary And Data: Leveraged Loans Return 0.79% In December, 9.66% In 2012

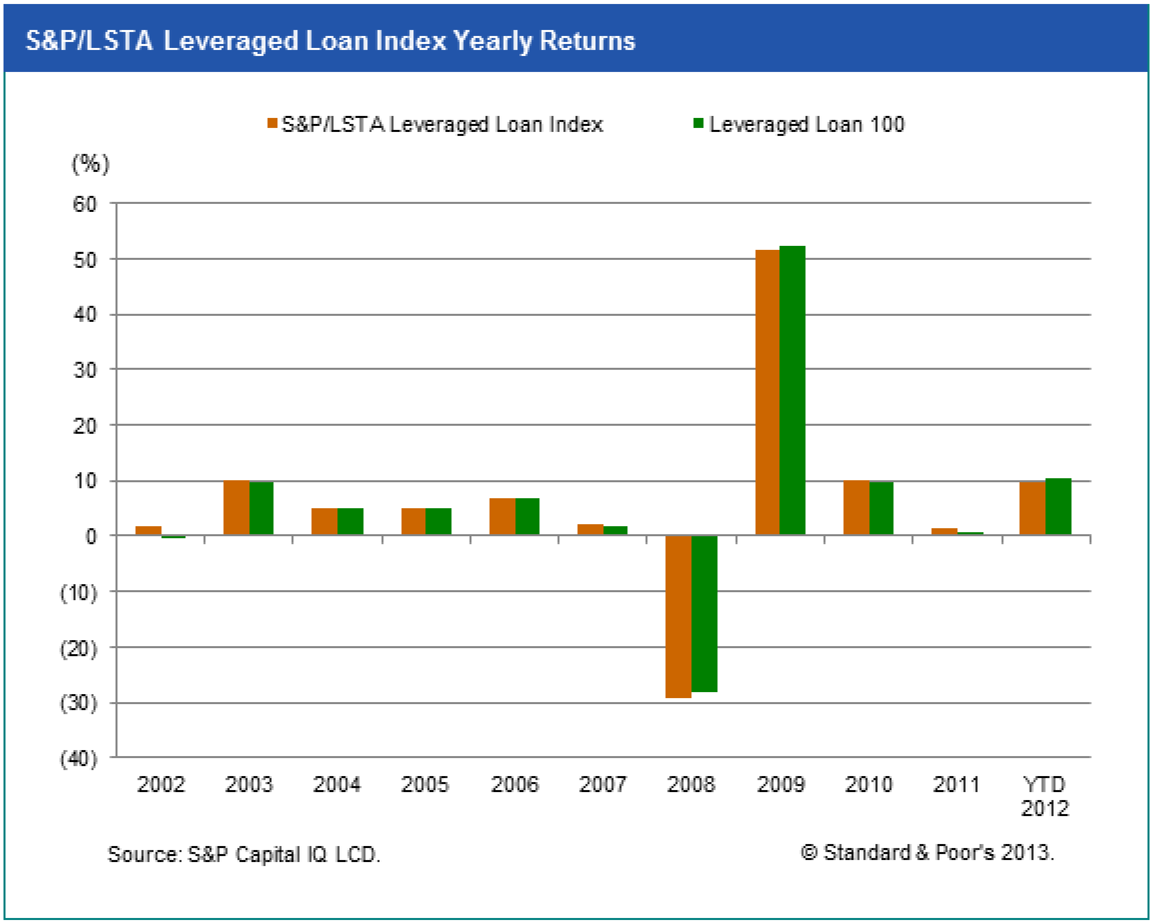
Propelled by muscular technical conditions and positive investor sentiment across the capital markets, the S&P/LSTA Loan Index posted its best performance in three months in December, returning 0.79%, up from 0.31% in November. The large loans that comprise the S&P/LSTA Loan 100 Index fared even better, returning 1.08% during the final frame of 2012, up from 0.07% in November (see chart 5).

Chart 5



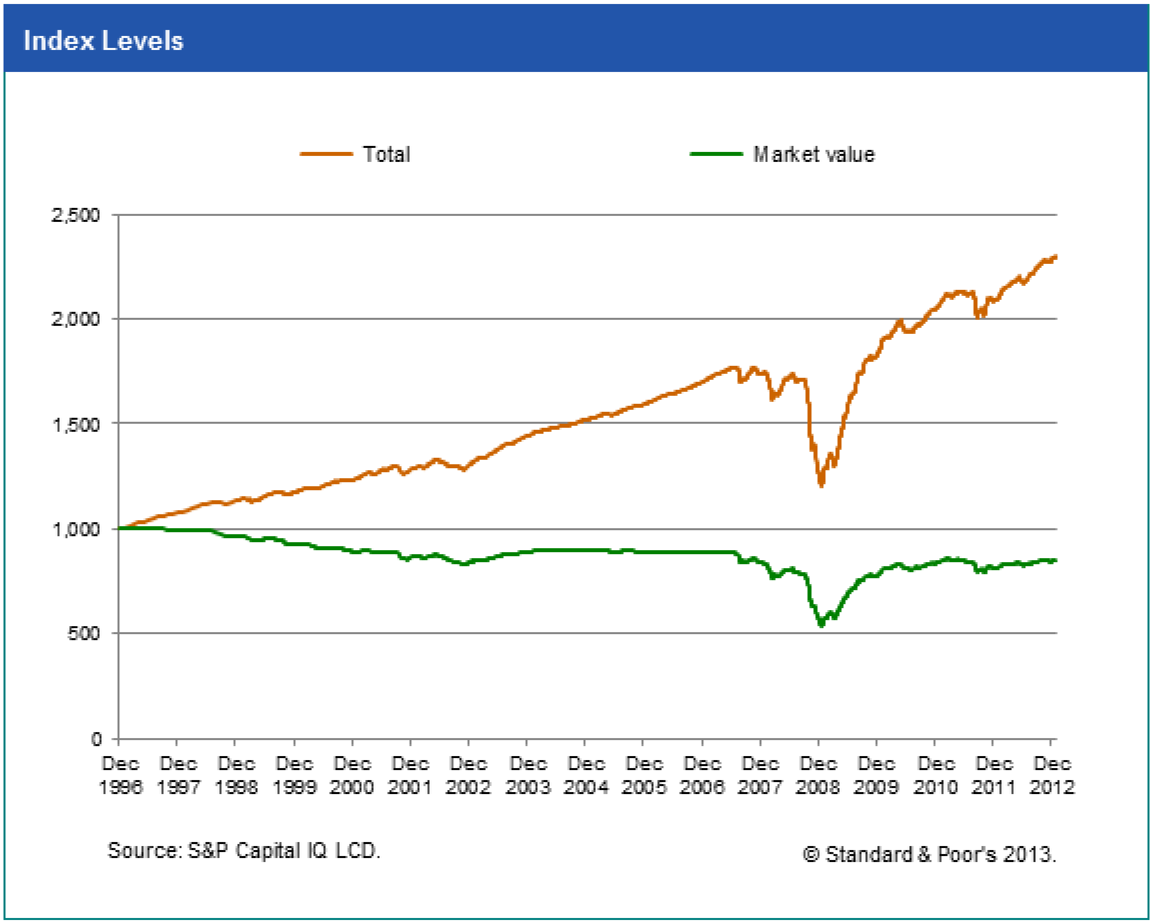
For the year as a whole, the S&P/LSTA Index returned 9.66%--the third best showing on record, following 2009's 51.6% and 2010's 10.1%--while the Loan 100 climbed 10.5%. Moreover, 2012's results are big improvement over 2011, when the S&P/LSTA Index eked out a 1.52% gain (0.63% for the Loan 100), with Standard & Poor's downgrade of the U.S.'s credit rating spooking investors after a fast start to the year (see chart 6).

Chart 6



As 2013 opens, the S&P/LSTA Index stands at a record level of 2,299 (see chart 7). That means that if an investor had put $1 into a generic loan portfolio on the Index commencement date of Jan. 1, 1997, and had reinvested interest and repayments along the way, that dollar would have growth to $2.30 on Dec. 31, 2012. On a market-value basis--excluding interest payments--the index ended 2012 at a 19-month high of 850.3. That means that the price drag of the index--including credit losses--over the past 16 years was 15 cents of the original dollar invested, or 0.89 cents a year on an annual compounded basis.

Chart 7



2012 In Review

December was, in many ways, a reflection of the year it concluded. Loan prices rose during the month as a result of a benign credit environment, technical strength, and a supportive macro backdrop--the "fiscal cliff" follies in Washington notwithstanding. We'll take each of these in turn.

With no new defaults among S&P/LSTA Index issuers in December, the loan default rate by principal amount ended 2012 at 1.27%, versus a near-record low of 0.17% at the end of 2011. Still, this measure of the market's fundamental health remains well below the historical average of 3.31%.

Turning to supply and demand, the revitalized CLO market saw another $7.3 billion of new vehicles print in December. Add to that an estimated $1.2 billion of new money to work in loan mutual funds (based on EPFR data on daily and weekly reporting funds and ETFs), and visible inflows to the asset class totaled $8.5 billion.

Meanwhile, outstandings in the S&P/LSTA Index--a proxy for overall supply--grew by $8.8 billion, or 1.62%, to a 39-month high of $551 billion.

The story was the same for all of 2012. Pumped up by $53.5 billion of new CLOs--the most since 2007--visible inflows exceeded supply growth by $27 billion: $61.9 billion to $34.9 billion. Loans also benefited from a relatively benign macro picture in 2012. The U.S. economy expanded an estimated 2.2% during the year despite risks from around the globe--the familiar list includes Europe's fragile debt situation, concerns about a hard landing in China, political gridlock in Washington, and growing tensions across the Middle East--as the market was unruffled by any outside shocks that have appeared so often in recent years. As one manager put it, the big surprise of 2012 was the absence of a disruptive negative

Given this cocktail of positive fundamental, technical, and macro factors, lower-rated, wider-margin loan paper continued to outperform in December, as it has all year.

Reading the tea leaves for 2013 requires putting aside the many potential game-changers listed above, including what may be an even bigger political struggle in Washington over the debt ceiling, expected in February.

That said, managers say the technical and fundamental stars are aligned for another supportive year for the asset class. Here's why:

Technicals: Most participants expect demand to continue to outstrip supply during the early days of 2013. On the supply side of the ledger, arrangers say that the visible pipeline for early 2013 is light. For one thing, arrangers report lackluster front-end LBO and add-on M&A activity beyond a handful of big deals in sight and a few more lurking in the mist. For another, arrangers expect the pace of recap loan volume to slow from the breakneck speed of the fourth quarter simply because so many issuers with the wherewithal to finance a dividend already hit the market before potential changes in the tax law took hold. On the other side of the ledger, by contrast, inflows to loan market show no sign of easing. Assuming no exogenous events, managers expect capital flows into the loan market to persist from all quarters: CLOs, mutual funds, and institutional allocations.

Fundamentals: Participants expect default rates to rise just modestly in 2013, according to LCD's latest quarterly buyside survey, conducted during the first half of December. On average, managers forecast a 2.04% default rate by principal amount for 2013, which, as mentioned above, is still well within the historical average of 3.31%. Of course, given all the things that could go wrong--many risks seen and unseen--it's understandable that investors continue to price a robust risk premium into loans. As of Dec. 31, the S&P/LSTA Index was trading at an average discounted spread of L+529, implying an imputed default rate of 4.28%, 2.01 percentage points wide of today's reading and 2.24 percentage points above managers' expected 2013 rate.

If these indicators prove prescient and 2013 turns out to be another year of lackluster economic growth and a low surprise quotient, the outlook for secondary loan prices is more small ball than long ball.

Undoubtedly, price gains in the year ahead will be limited by the fact that the average price of the S&P/LSTA Index ended 2012 at 96.78% of par, the highest level since Oct. 21, 2007. Excluding TXU--which, participants say, faces a likely 2014 bankruptcy once certain gas hedges expire--the average is higher still, at 97.80. What's more, if broad-shouldered conditions persist, managers worry that issuers will exercise their call options and set off a new repricing wave that lowers the average Index spread. A scan of the S&P/LSTA Leveraged Loan Index shows a healthy population of potential candidates. Among Index loans that are already through their soft call period or will be by March 2013, $273 billion were bid at 99 or higher as of Dec. 28.

These factors leave little room for price increases to move the return needle for loans. The downside, meanwhile, is also likely limited given the default outlook described above--again assuming away a macro event that roils the capital markets.

With this in mind, 2013 will likely tamp down the historical volatility of the asset class, which, obviously, was greatly inflated by the 2008 bust and 2009 boom in loan returns.

Consider these data. The standard deviation of monthly returns for the S&P/LSTA Index fell to a seven-year low of 0.67%

in 2012, from 1.73% in 2011. That pushed the historical standard deviation of loan returns to a 44-month low of 1.88%, versus an all-time peak of 2.0%, from September 1999.

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

Municipal Bond Commentary: Municipal Bonds Outperformed Gold In 2012

Investment-grade municipal bonds, as tracked by the S&P National AMT-Free Municipal Bond Index, returned 6.52% in 2012 while gold, as tracked by the S&P GSCI Gold TR Index, returned 6.02%.

Key market drivers and results:

Flight-to-quality investors helped maintain the supply/demand imbalance throughout the year by driving municipal bond mutual fund cash inflows. The result was reflected in investment-grade yields falling by about 78 basis points (bps) in the 10-year range, or the "belly of the curve."

Fund flows slowed at year-end and the unresolved fiscal cliff issues surrounding the future tax treatment of municipal bonds certainly were a factor.

Low yields continue to be a concern for the marketplace, but in relative terms, the yields on municipal bonds remain higher than those of other asset classes. Yields in the 10-year range as tracked by the S&P AMT-Free Municipal Series 2022 Index (noncallable, investment-grade, average Standard & Poor's rating of 'AA') are a good indicator. The S&P AMT-Free Municipal Series 2022 Index ended 2012 with a tax-exempt yield-to-maturity of 2.27%, or 51 bps higher than the 10-year U.S. Treasury bond. The taxable equivalent yield of these bonds was 3.76%, or 202 bps higher than the 10-year U.S. Treasury bond.

Yield-hungry investors helped drive high-yield municipal bonds to a total return of 18.46%. This was the second highest annual return in the S&P Municipal Bond High Yield Index's history. 2009 holds the record for highest annual return, recording a total return of over 34%, which followed a record decline in 2008 of 28%.

Municipal bond defaults:

Several high-profile municipal bankruptcy filings occurred in 2012. This raised concerns about the prospect of municipalities strategically filing bankruptcy to better navigate their heavy pension obligations, mostly at bondholders' expense. While strategic defaults were not a trend in 2012, this is something the market is watching as we enter 2013.

The S&P Municipal Bond Index recorded 52 bond deals in default for the first time in 2012, representing 78 individual bonds in the index and totaling over $3.033 billion in par value. During 2012, 46 defaulted bond deals made their final payment to bondholders, representing $1.55 billion in par value. As a result, these defaulted bond issues are considered no longer outstanding. At year-end, outstanding defaults in the index totaled 205 bond issues, representing over $7.5 billion in par value and 0.54% of the total par value of the index ($1.4 trillion).

2012 was characterized by volatility. However, in general, municipal bonds were less volatile than other asset classes (see tables 2 and 3).

Table 2

2012 Asset Class Standard Deviations

S&P National AMT-Free Municipal Bond Index	S&P 500 TR	S&P GSCI TR	S&P/BGCantor US Treasury 7 – 10 Year Index	S&P GSCI Gold TR	S&P/LSTA U.S. Leveraged Loan 100
2.34	5.03	5.41	2.76	5.65	3.1

Table 3

2012 Correlations for the S&P National AMT-Free Municipal Bond Index

S&P 500 TR	S&P GSCI TR	S&P/BGCantor US Treasury 7 – 10 Year Index	S&P GSCI Gold TR	S&P/LSTA U.S. Leveraged Loan 100
0.672	(0.268)	0.876	0.230	0.920

Contact Information: James Rieger, Vice President—S&P Dow Jones Indices, James_Rieger@spdji.com

Market Derived Signal Commentary: The Consumer Discretionary Sector Is Poised For Improvement

Despite initial indications suggesting weak holiday sales from MasterCard and others, potentially driven by consumer fear of slower economic growth as the U.S. approached the fiscal cliff, S&P 500 consumer discretionary companies are expected to report the strongest fourth-quarter earnings growth (12.1%) of any of the 10 sectors, outpacing financials (10.5%), which prognosticators had recently forecast as the frontrunner.

Retail sales actually rose 4.5% in December, outpacing analysts' expectations for 3.3% growth, according to a Thomson Reuters poll released Thursday.

Analysts see household durables leading consumer discretionary growth at 55%, followed by specialty retailers and textiles/apparel/luxury goods retailers, according to data aggregated by S&P Capital IQ. But other industries are not expected to fare as well as the S&P Capital IQ consensus estimate shows. Earnings per share forecast for the sector declined from $6.33 per share on the first day of the fourth quarter to $6.11 on Thursday, a drop of 3.5%.

The risk premium for the sector has remained almost flat at 304 basis points (bps) over the past three months, according to CMA, a division of S&P Capital IQ. By subsector, five-year credit default swap (CDS) spreads for automobiles and automobile components tightened 11.2% to 282 bps, while the average spread for consumer durables and apparels tightened by 1.7% to 239 bps. Consumer services widened 4.4% to 351 bps, media widened 1.3% to 279 bps, and retailers widened 3% to 386 bps.

GMI Research thinks the average spread for consumer discretionary companies will potentially contract modestly from the current level since the U.S. fiscal cliff crisis has now been averted. Over the week ended Jan. 2, the average spread had already tightened 3.6%. Positive fourth-quarter earnings reports and an optimistic outlook for 2013 from these companies would go a long way in further restoring the credit market's confidence in the sector.

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

Capital Market Commentary: IPOs, M&A, And Debt

IPOs

Sometimes, bottom fishing can be a lucrative endeavor, when unwanted or discarded items later become valuable. In the initial public offering (IPO) market, that has been the case in some instances as seen below in the 2012 performance of

2011's laggards (see tables 4 and 5). Using S&P Capital IQ data, we uncovered the worst performers among 2011's U.S. IPOs and examined their 2012 performance. Of the 10 largest percentage decliners in 2011, six showed gains last year while four continued to lose ground. Yet, because two issues--Imperial Holdings Inc. and AcelRx Pharmaceuticals Inc.--registered better than 100% gains in 2012, the 10 worst performing IPOs in 2011 delivered an overall gain of better than 16% in 2012.

We extracted the IPOs with the greatest percentage declines in 2012. Whether these issues recover will likely depend on their ability to meet earnings expectations as well as the performance of their industry group.

Table 4

2011 IPO Laggards And 2012 Performance

	Issuer	Total transaction value ($mil.)	Price per share ($, historical rate)	Day close price, 12/31/2011 ($)	2011 performance	Day close price, 12/31/2012 ($)	2012 performance
5/10/2011	FriendFinder Networks Inc.	50.0	10.00	0.75	(92.50)	0.62	(17.33)
2/10/2011	Kips Bay Medical Inc.	16.5	8.00	1.34	(83.25)	0.63	(53.13)
2/7/2011	Imperial Holdings Inc.	179.2	10.75	1.88	(82.51)	4.45	136.70
2/10/2011	AcelRx Pharmaceuticals Inc.	40.0	5.00	1.92	(61.60)	4.26	121.88
1/25/2011	Demand Media Inc.	151.3	17.00	6.65	(60.88)	9.29	39.70
2/1/2011	NeoPhotonics Corp.	82.5	11.00	4.58	(58.36)	5.74	25.33
2/8/2011	Gevo Inc.	107.3	15.00	6.29	(58.07)	1.54	(75.52)
7/27/2011	Horizon Pharma Inc.	49.5	9.00	4.00	(55.56)	2.33	(41.75)
2/1/2011	Epocrates Inc.	85.8	16.00	7.80	(51.25)	8.82	13.08
6/21/2011	Vanguard Health Systems Inc.	450.0	18.00	10.22	(43.22)	12.25	19.86

Source: S&P Capital IQ.

Table 5

2012 IPO Laggards

	Issuer	Total transaction value ($mil.)	Price per share ($)	Day close price, 12/31/2012 ($)	2012 performance
4/24/2012	Envivio Inc.	69.80	9.00	1.70	(81.11)
3/28/2012	CafePress Inc.	85.50	19.00	5.77	(69.63)
2/21/2012	Ceres Inc.	65.00	13.00	4.54	(65.08)
2/7/2012	Roundy's Inc.	163.05	8.50	4.45	(47.65)
4/19/2012	Midstates Petroleum Company Inc.	312.00	13.00	6.89	(47.00)
2/10/2012	HomeStreet Inc.	83.44	44.00	25.55	(41.93)
1/18/2012	Renewable Energy Group Inc.	72.00	10.00	5.86	(41.40)
3/29/2012	Enphase Energy Inc.	53.82	6.00	3.65	(39.17)
5/9/2012	Audience Inc.	89.59	17.00	10.39	(38.88)
4/26/2012	Edgen Group Inc.	165.00	11.00	7.06	(35.82)

Source: S&P Capital IQ.

M&A

In a previous report, we highlighted the recent acquisitions of some newly public companies (see "Cross-Market Commentary: Companies Target Recent IPOs For Acquisitions," published Nov. 15, 2012). For example, less than three months after completing its IPO in July 2012 at an offer price of $26 per share, Kayak Software Inc. announced that it had received an offer to be acquired by Priceline.com Inc. for $40 per share. Some deals, however, are valuing the target company below their initial offer price. This week, The Carlyle Group L.P. signed a definitive agreement to acquire Duff & Phelps Corp. for approximately $660 million--or $15.55 a share--in cash on Dec. 30, 2012. The target had gone public in September 2007 at $16 a share. Similarly, Avis Budget Group Inc. recently entered into an agreement to acquire Zipcar Inc. for approximately $490 million in cash, or $12.25 a share. Zipcar completed its IPO in April 2011 at $18 a share (see table 6).

Given that nearly two-thirds of the 2012 IPOs that reported third-quarter earnings results exceeded S&P Capital IQ consensus estimates, there are plenty of candidates for a potential acquirer. It remains to be seen how many of the IPOs with above consensus earnings but sub-performing stock prices will receive takeover bids in 2013? We'll be keeping a keen eye on any such developments.

Table 6

Takeunders: Recent M&A Deals Involving Past IPOs Below Their Offer Price

Date	Target	Acquirer	M&A value ($mil.)	M&A offer per share ($)	Target IPO price per share ($)
9/27/2012	Sealy Corp.	Tempur-Pedic	1,018.0	2.20	16
12/30/2012	Duff & Phelps	Caryle Group	695.3	15.55	16
1/2/2013	Zipcar	Avis	647.2	12.25	18
11/14/2012	Teavana	Starbucks	620.7	15.50	17
9/17/2012	Complete Genomics	BGI	133.4	3.15	9

Source: S&P Capital IQ.

Debt

2012 ended on a mixed note with regard to identifier requests for selected debt security offerings. Looking at CUSIP Global Services data, our review of six selected debt asset classes showed a dead heat between identifier requests for of November and December (see table 7). Results are similar for the full year, as the two debt asset classes with the largest number of CUSIP requests--domestic corporate debt and municipals--diverged. Corporate debt CUSIP requests changed little from 2011, while municipal identifier orders rose significantly faster than overall total debt identifier orders.

Given the ongoing public finance requirements at various levels of government, as well as the expectation of low interest rates for many corporate borrowers, it would be reasonable to predict another positive year for CUSIP activity, which should translate into a stable period for capital markets.

Table 7

Selected Debt Securities CUSIP Requests

	December	November	2012	2011	Year-over-year change (%)
Domestic corporate debt	905	791	10,308	10,332	(0.23)
Municipal debt	1,277	1,407	16,683	13,317	25.28
Short-term muni note	138	86	1,539	1,668	(7.73)
Long-term muni note	24	13	560	382	46.60
International debt	147	178	1,539	1,668	(7.73)

Table 7

Selected Debt Securities CUSIP Requests (cont.)					
PPN domestic debt	189	206	2,262	1,433	57.85
Total	2,680	2,681	32,891	28,800	14.20

Source: CUSIP Global Services.

Contact Information: Rich Peterson, Director—Global Markets Intelligence, Richard_Peterson@spcapitaliq.com

S&P Index Commodity Commentary: Agriculture And Precious Metals Were The Best Performers In 2012--But The Worst In December

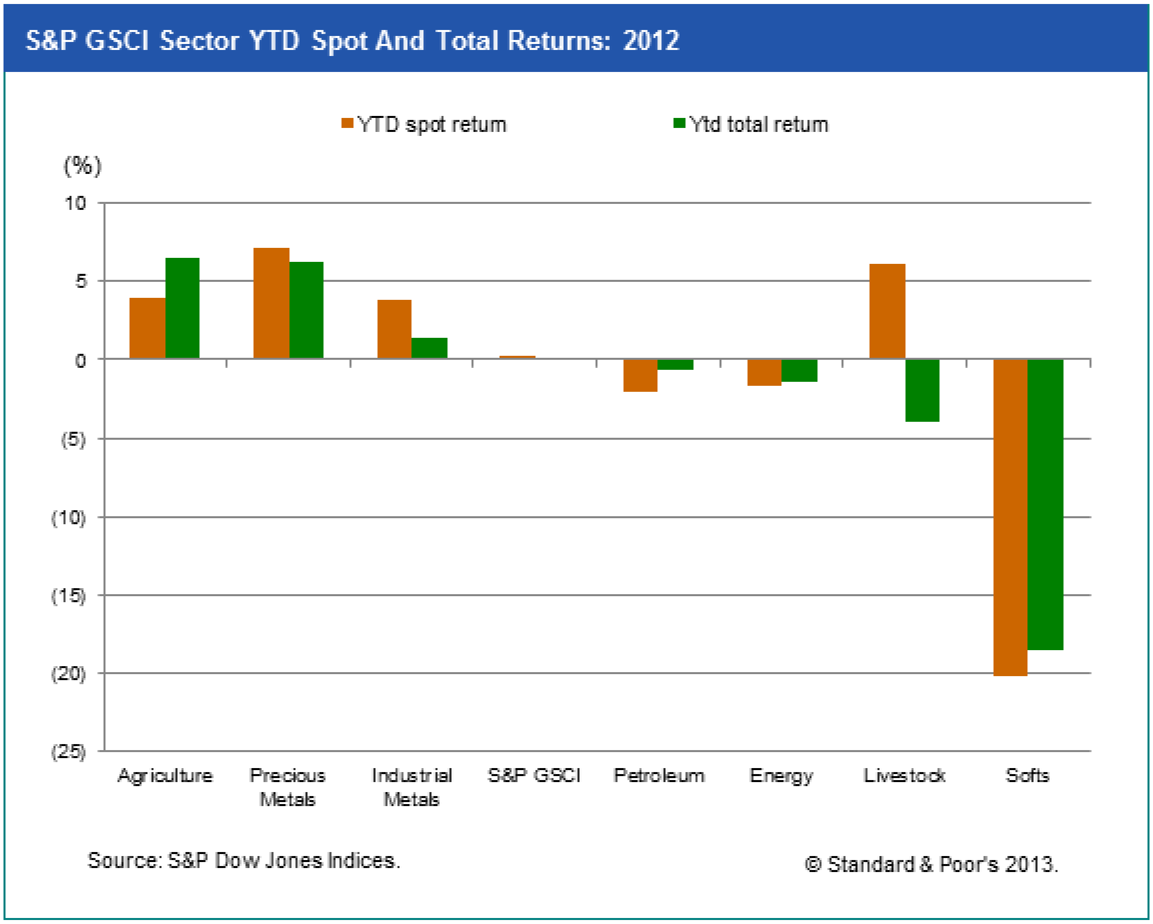
The S&P GSCI ended 2012 with a slight gain of 0.08%, after a 0.65% decline in December. Agriculture and precious metals were the best performing major sectors in the year as a whole, but were the worst performers in December, with a 5.71% month-to-date decline in the S&P GSCI Agriculture Index and a 3.16% month-to-date decline in the S&P GSCI Precious Metals Index. Year-to-date, agriculture was the best performing major sector in terms of total returns, with a gain of 6.46% in the S&P GSCI Agriculture Index. This includes the 16.22% increase in the S&P GSCI Grains Index, which was mostly because of decreased U.S. production resulting from severe drought conditions. The S&P GSCI Precious Metals Index gained for the 12th consecutive year in 2012 on the back of continued global monetary stimulus and increasing investment demand, despite waning interest from India and China.

The 1.37% year-to-date decline in the S&P GSCI Energy Index, which included an 11.52% decline in the S&P GSCI Crude Oil Index, was the largest drag on index returns in 2012. Increasing North American production and supplies of crude oil and natural gas pressured energy prices in 2012, but other commodities did better, with a 3.48% year-to-date gain in the S&P GSCI Non Energy index. In December, the S&P GSCI Energy Index gained 0.63%, with a 2.63% recovery in the S&P GSCI Crude Oil index.

The S&P GSCI Industrial Metals Index declined 0.99% in December, which reduced the year-to-date increase to 1.37%. Optimism for global industrial metal demand was somewhat curtailed by recession in Europe and slowed economic growth in China.

Despite a 6.09% year-to-date gain in the S&P GSCI Livestock Spot Index, rolling into contango (when further out futures are higher) resulted in a 3.95% year-to-date decline in the total return index, making it the worst performing major sector index in 2012. In the base index, however, 2012 was generally characterized by rolling into backwardation--notably in the agriculture sector, which included a 1.42% year-to-date decline in the S&P GSCI 3 Month Forward Index compared with the 0.08% gain in the base S&P GSCI (see chart 8).

Chart 8



Contact Information: Mike McGlone, Senior Director—S&P Dow Jones Indices, Mike_McGlone@spdji.com

About S&P Capital IQ and S&P Indices Research & Analytics

S&P Capital IQ Research & Analytics

Global Markets Intelligence

Provides event-driven, multi-asset class market commentary and analysis; model development, and investment advisory services.

Research

Provides global company and funds research including insight into the performance of the world's leading investment funds.

Leveraged Commentary and Data

Delivers insight into the leveraged loan market through a combination of data, commentary, analysis, and real-time news.

S&P Indices

The world's leading index provider maintaining a wide variety of investable and benchmark indices to meet an array of investor needs.

Sign up for your complimentary subscription: www.standardandpoors.com/lookout