S&P CAPITAL IQ

Lookout Report
from Global Markets Intelligence

Stocks And Housing Are Cheap Relative To Prior Peaks In the Equity Market

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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.

For the third time in 13 years, the S&P 500 Index is attempting to stay above 1,500, a level that was previously reached only briefly in 2007 and 2000. The 1,500 milestone is now associated historically with the bursting of the tech stock bubble at the start of the new millennium and then the bursting of the housing market bubble in 2007/2008. Considering that these events resulted in considerable financial loss for many investors, it is not too surprising that some stock market technicians are now warning of a potential "triple top" in the equity market.

With market interest rates and bond yields holding at extremely low levels, many investors are once again viewing the stock market as a source of relatively attractive and acceptable investment returns. This places many investors in what is perhaps an uncomfortable or even a potentially risky position, contemplating larger portfolio allocations to stocks at a time when the market is trading at levels that have previously resulted in capital losses as opposed to capital gains.

So how should investors interpret the current value proposition the equity market presents, with the S&P 500 Index trading just north of the vaunted 1,500 level? For starters, stocks are not nearly as expensive today as they were in 2000 and 2007. On a forward four-quarter basis, the market is currently trading just 13.6x expected 2013 S&P 500 earnings-per-share (EPS) of $111.28 according to the S&P Capital IQ consensus. This compares to a forward price-to-earnings (P/E) ratio of 27.4x in the third quarter of 2000 and 20.2x in the third quarter of 2007 (see chart 1). In our opinion, the current 13.6x multiple seems entirely appropriate, or perhaps even a little modest, relative to just-reported S&P 500 earnings growth of 6.5% for the final quarter of 2012.

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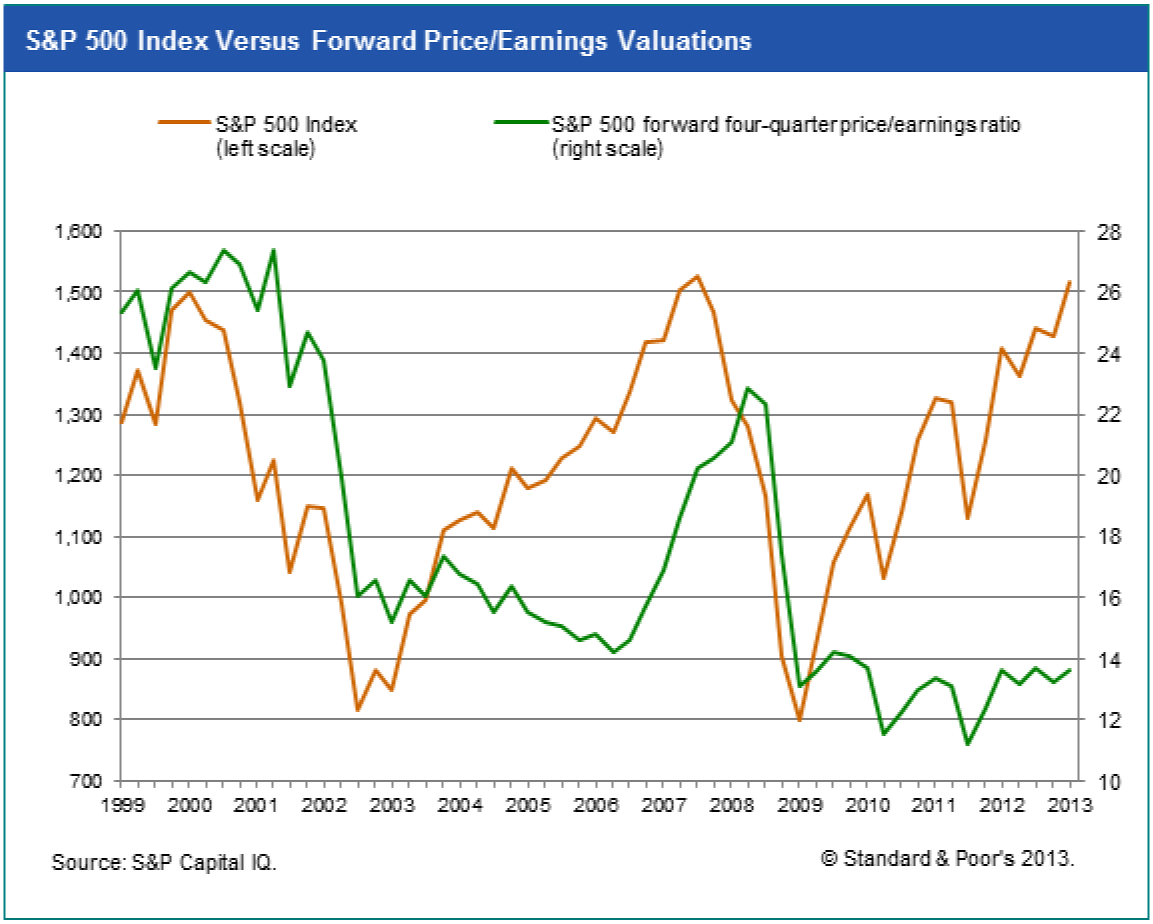
Chart 1

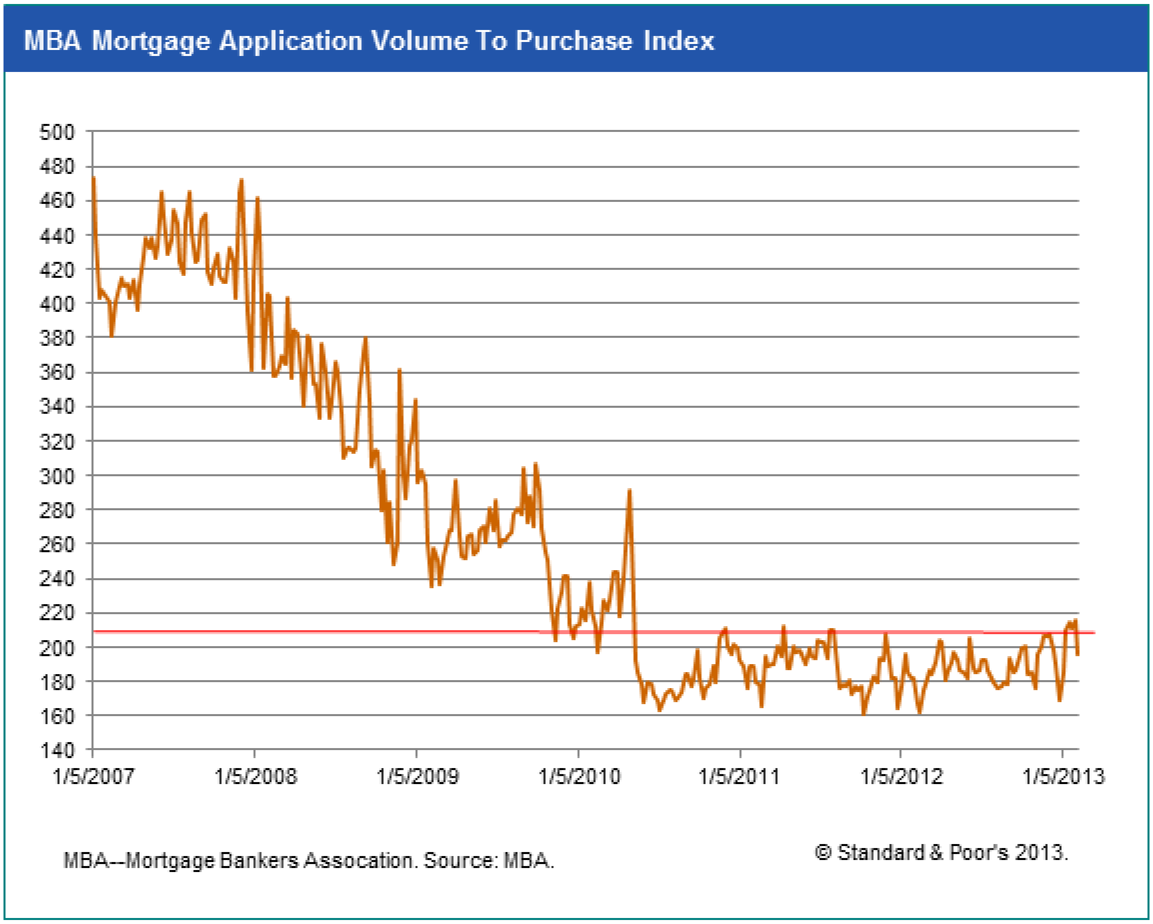


With the S&P 500 Index mounting its third attempt at capturing 1,500, the real question facing investors is whether corporations are well positioned to deliver the earnings growth that analysts and investors expect in the months and years to come. This question is directly related to the challenge facing U.S. policymakers at the start of 2013, which is to chart a path for the economy that leads to sustained robust growth. In the opinion of Global Markets Intelligence (GMI) Research, this will require that monetary accommodation more than offsets the drag resulting from fiscal restraint in the form of higher personal income taxes and reduced Federal deficit spending. Where corporate performance and profitability are concerned, S&P 500 fourth-quarter earnings are encouraging. S&P 500 corporations were expected to post 3.2% growth at the start of Q4 earnings season at the beginning of January but have surprised on the upside with 6.8% growth as of Feb. 15 with 79% of index members having reported their earnings.

Preliminary 2013 evidence suggests that the Fed's QE3 policy is gaining some traction with prospective U.S. homebuyers. The Fed's monthly purchases of $45 billion of agency mortgage-backed securities and $40 billion Treasury securities are keeping borrowing costs low while simultaneously force-feeding the housing market financing liquidity. Although it's too early to consider it a trend, the Mortgage Bankers Association applications-to-purchase index is showing signs of life. The index recently ticked incrementally higher to 216 the week of Feb. 1, the best level since May 2010, before dipping back to 195 as of this week's report (see chart 2).

The ongoing and extended period of historically modest consumer demand for housing suggests that housing continues to be a significant potential catalyst for considerably stronger U.S. economic activity, but sustained positive updates on housing and job creation are required if the bull market in stocks and the recovery in housing are going to gain momentum in 2013. Assuming there won't be another recession, we can say with some degree of certainty that stock market valuations and housing affordability are considerably more attractive today than in either 2007 or 2000--the previous occasions when investors evaluated their exposure to equities while the S&P 500 Index tested the 1,500 level.

Chart 2



Inside This Issue:

Macroeconomic Overview

For the third time in 13 years, the S&P 500 Index is attempting to stay above 1,500, a milestone now associated historically with the bursting of the tech stock bubble at the start of the new millennium and then the bursting of the housing market bubble in 2007/2008. But stock market valuations and housing affordability are considerably more attractive today than in either 2007 or 2000.

Economic And Market Outlook: North American And European Earnings

Fourth quarter S&P 500 earnings are at new highs after another week of impressive reports. And in Europe, calendar-year 2012 earnings estimates for the S&P Europe 350 Index have begun to recover.

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Leveraged Commentary And Data: Hotter Than Hell: January Liquidity Surge Fuels Loan Technical Fire

Loan market technical conditions reached a fever pitch in January, but then cooled slightly in early February, thanks in part to Dell's boost to the forward calendar. Before we examine the latest action, let's review the numbers behind January's technical blowout.

R2P Corporate Bond Monitor

The U.S. economy likely expanded slightly in the fourth quarter as higher exports and a slump in oil imports narrowed the trade gap. Conversely, eurozone output declined again in January despite strength in Germany.

Market Derived Signal Commentary: Credit Market Thinks Ireland Is Headed In The Right Direction

Standard & Poor's Ratings Services acknowledged Ireland's success in turning around its once dire fiscal position when it revised the country's outlook to "stable" from "negative" on Feb. 11, 2013. The credit market's view of Ireland as a high-risk sovereign has changed remarkably, but the country has a way to go to be in the same company as France and Germany.

Market Commentary: Eurozone Sovereign Debt: Irish Eyes Are Smiling

Mixed in with all the daily market commentary was a bright spot for one of the member countries of the S&P Eurozone Sovereign Bond Index. It's not St. Patrick's Day, it's not even March, but Irish luck prevailed--Ireland won a key victory by refinancing the debt package that funded its broken banks.

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

Less than halfway through the first quarter of 2013, evidence is suggesting that it's going to be a strong year for underwriting fees from initial public offerings. The findings show the robust state of capital markets at this time and point toward prospective healthy earnings for the financial sector this quarter.

S&P Index Commodity Commentary: Positive Sentiment Helps, Despite The Weather

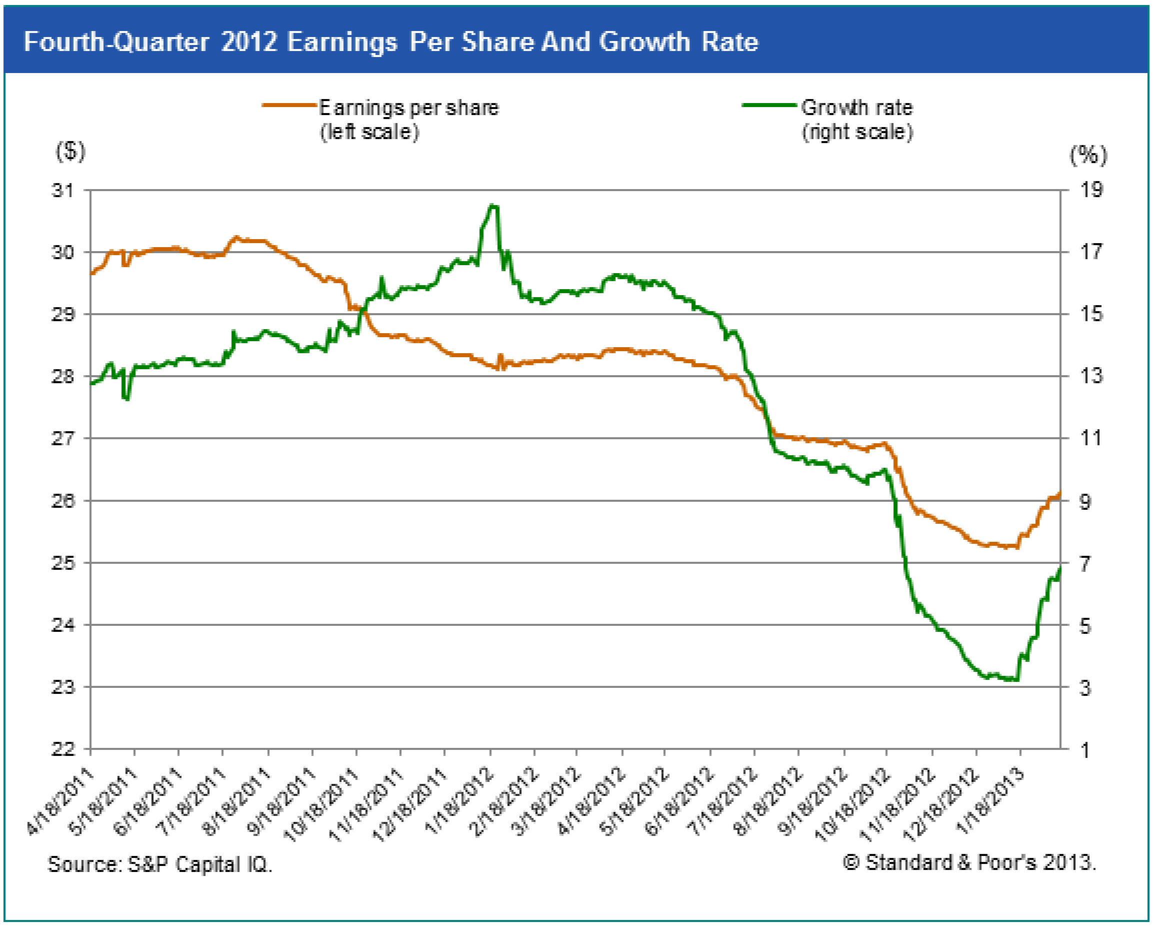
Commodities are mixed this month. Energy has continued to benefit from promising economic data from China and the U.S., but agriculture has suffered due to favorably wet growing conditions that have driven down prices.

Economic And Market Outlook: North American And European Earnings

North America

Fourth quarter S&P 500 earnings are at new highs after another week of impressive reports. 65% of the 396 companies have beat analysts' estimates, propelling the overall growth rate to 6.8% (see chart 3). While this is below the average 12-year growth rate of 8%, earnings per share of $26.13 are a record for the S&P 500, topping last quarter's record of $26.05. Stronger-than-expected results from the information technology sector (in which 82% of companies beat earnings estimates) and financials sector (68% beat estimates) are responsible for lifting the index higher.

Chart 3



Despite the new earnings per share record, there are mixed feelings about how this earnings season is shaping up. While 65% of companies have beaten analysts' estimates, surpassing the historical average of 62%, they have only done so by an average of 4.2%. This is lower than the historical ratio of 6%. However, it is important to remember the problems with year-over-year comparisons, which could explain why some investors aren't concerned by slowing profit growth. We are currently seeing record profits on top of record profits from the prior year, so a lower growth rate is unsurprising but creates the illusion of a ho-hum season. S&P 500 companies reported record earnings in 2011 and are on pace for another banner year in 2012.

And while investors seem to sense better times ahead, as the multiyear highs of the S&P 500 Index indicate, they are ignoring the negative guidance the companies have provided. Currently, 93 companies have issued guidance for the first quarter of 2013. Of those, 65 are negative, 24 positive and four in line, producing a negative to positive ratio of 2.7, higher than the 10-year average of 2.0 (see table 1). Many executives have commented that they continue to see weakening economies in Europe and domestically they worry about hesitant U.S. customers and continued gridlock in Washington.

Table 1

Corporate Guidance

	Q2 2012	Q3 2012	Q4 2012	Q1 2013
Number of companies				
Positive	28	22	20	24
In line	17	7	13	4
Negative	65	72	65	65
Total	110	101	98	93
% of total companies				
Positive	25.5	22	20.4	26
In line	15.5	7	13.3	4
Negative	59	71	66.3	70
Negative-to-positive ratio (x)	2.3	3.3	3.3	2.7

Source: S&P Capital IQ.

One metric that continues to improve this quarter is top-line growth, now pegged to come in at 4.7%. While this is lower than the 10-year average of 7%, it is a marked improvement from third-quarter 2012's very low figure of 0.4%. Not only is revenue growth on the rise, but so are the number of companies beating analysts' sales estimates. Of the 378 companies that have reported thus far, 65% have surpassed expectations, better than the historical average of 61% and vastly exceeding the mere 38% reported last quarter, which was the lowest such figure in the 10 years S&P Capital IQ has been tracking this data.

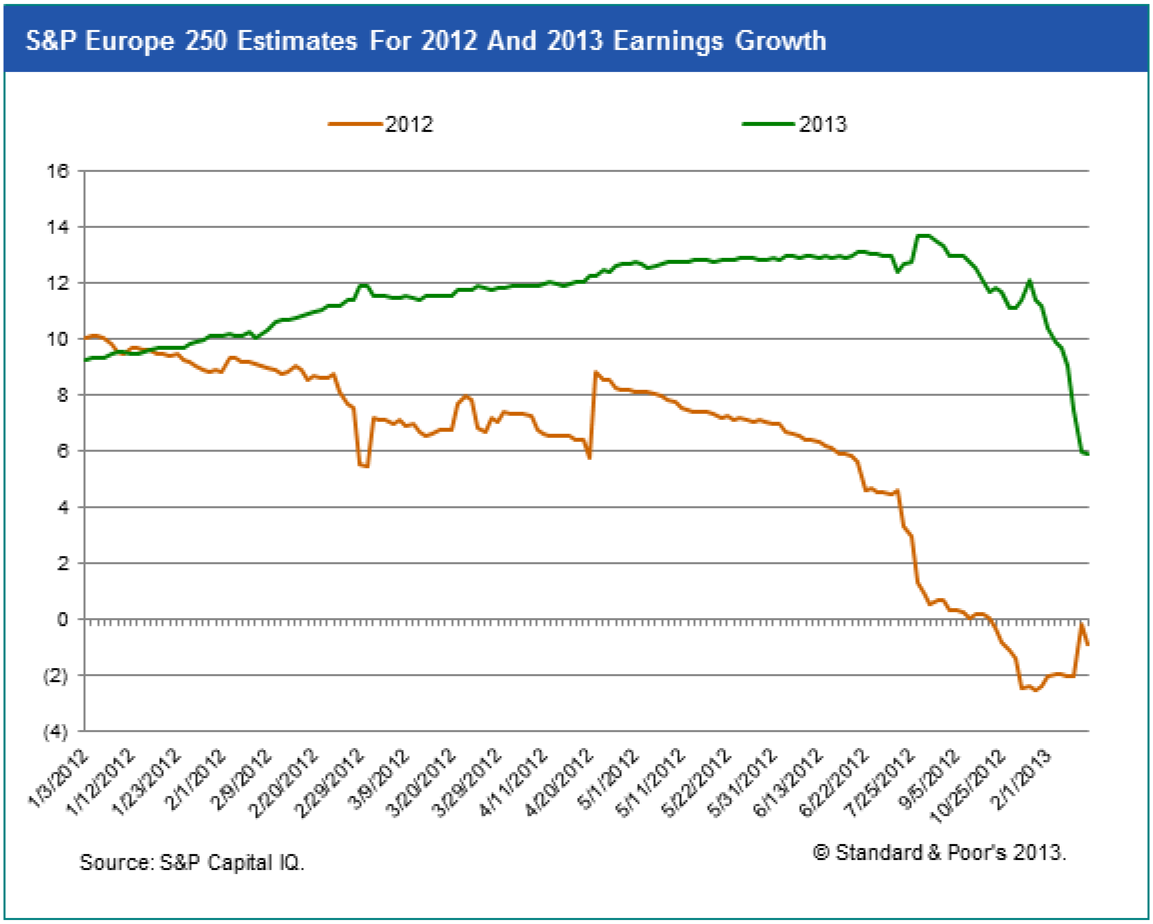
Fourth-quarter earnings season begins to wind down next week, with only 50 companies scheduled to release results.

Europe

Peak earnings season continued this week for companies in the S&P Euro 350, with 45 companies releasing both their fourth-quarter and full-year figures. Unlike the S&P 500, not all Euro 350 companies will report quarterly results. Analysts expect only 203 (58%) of these companies to report for the quarter, but this is typical of European companies as they are not required to issue quarterly filings. All companies will report for 2012, however.

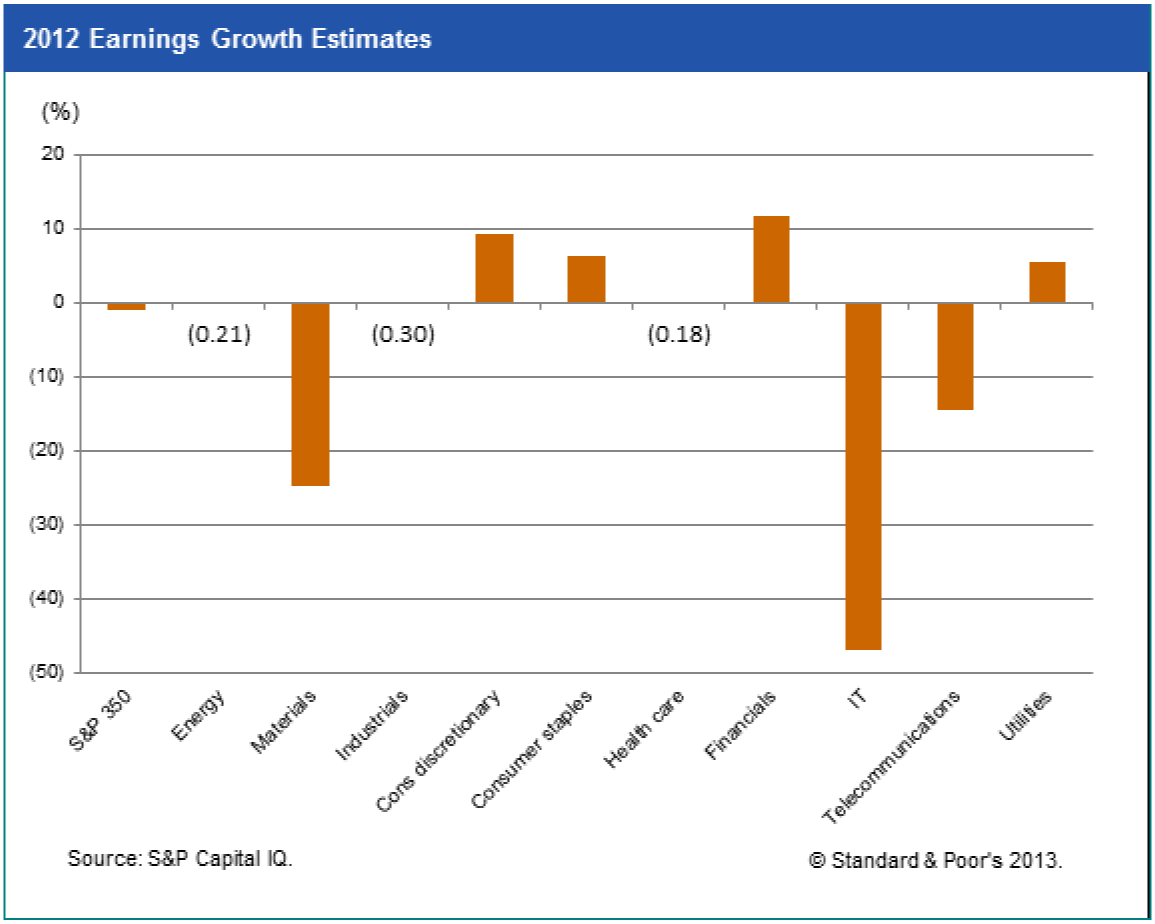
Calendar-year 2012 earnings estimates for the S&P Europe 350 Index have begun to recover over the last two weeks (see chart 4). On Feb. 1, estimates stood at negative 2.07%, but because of some impressive results during the first two weeks of peak earnings season, the 2012 growth rate has improved to negative 0.91%. This is much improved from the negative 2.53% posted during the week of Nov. 26, the lowest estimate in the fourth quarter. Despite the uptick, European companies are still poised for a second yearly earnings growth decline, after 2011 ended with negative growth of 1.89%. Five of 10 sectors (energy, materials, health care, information technology, and telecommunication services) are already expected to come in negative in 2012.

Chart 4



Similar to fourth-quarter results for the S&P 500, the financials sector of the S&P Europe 350 is expected to lead growth in 2012 with 11.7% (see chart 5). In just the last two weeks, estimates for the sector have improved by 6.07%, more than any other sector. Since earnings season began, seven banks have reported results, including heavy hitters UBS AG, Credit Suisse Group, Barclays PLC, Societe General Group and BNP Paribas SA. Results for these banks have been mixed, with Credit Suisse, Barclays and Societe General all missing analysts' earnings expectations for the fourth quarter. On the other hand, UBS and BNP Paribas were able to beat both on the top and the bottom line. Barclays in particular is expecting a weak 2013, and is hoping to offset that weakness with its newly proposed three year strategy to cut costs. The plan includes cutting 3,700 jobs, or less than 4% of its total workforce, as well as scaling back its European and Asian equities businesses in order to boost returns.

Chart 5



Next week, earnings season for the Euro 350 continues, with 40 companies scheduled to release results.

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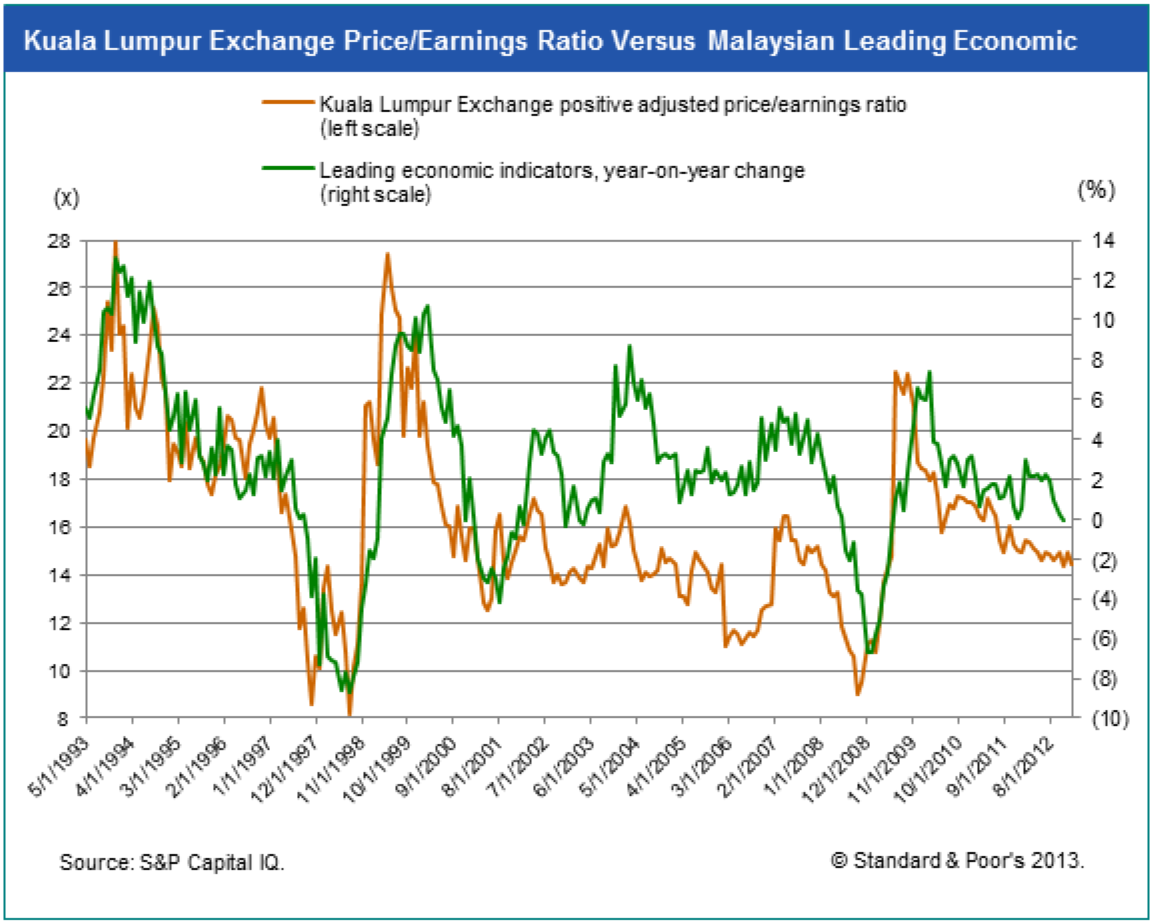
International Update: Reversion To Sustainable Economic Growth Likely To Rally The Malaysian Stock Market

Malaysian shares' double-digit capital appreciation last year has turned to modest depreciation in the 45 days since the start of 2013. Nothing--except perhaps the upcoming national elections--would seem to be a clear cause for the mild reversal of fortunes for equities on the Kuala Lumpur Exchange (see chart 6). Macroeconomic activity will probably reduce further during the first half of the year, but a likely recovery in Singaporean and Chinese industrial demand should help restore vigor to Malaysian exports with little or no threat from inflation. That augurs well for the domestic stock market in the latter half of 2013.

An increase in production of between 5% and 6% looks attainable this year, after the slowdown in real economic momentum to an estimated 4.5% in 2012 reminded both authorities and investors alike of Malaysia's reliance on foreign sources of raw material demand--especially from China and Singapore. The appreciation in the Malaysian ringgit against the U.S. dollar of nearly 17% since last year (almost 51% in inflation-adjusted effective exchange rate terms) has hampered Malaysian exports, but conditions could improve later this year. A reduction in imports should forestall a deterioration of the trade and current account surpluses until a revival in overseas demand for domestic products later in

2013 reestablishes stability in export growth.

Chart 6



The Barisan Nasional (BN) coalition regime, whose largest member party is the United Malays National Organization (UMNO), will complete its current term in April and hold nationwide parliamentary balloting in May. We expect BN to overcome another stiff challenge from the opposition party Pakatan Rakyat (PR) and return to form a majority government. Auspicious economic conditions would seem to assure the reelection of BN under Prime Minister Najib Razak for another five-year term, conveying a convincing message to investors abroad that Malaysia's stable politics and policymaking will make for a favorable business climate.

Irrespective of the weak start to the year, Malaysian shares overall appear compellingly attractive. As the region's economy regains its strength, Malaysia's equity markets should benefit accordingly. Trading at 14.5x forecast 2013 earnings, the Kuala Lumpur stock exchange may seem expensive when compared to its 8.2x historical low. However, when measured against its average (16.3x) and all-time high (27.9x), the 2013 forward market price/earnings multiple appears alluringly cheap. Furthermore, a comparison with neighboring Asian exchanges reveals Malaysia's relative inexpensiveness with respect to Taiwan (14.6x), India (15.6x), Singapore (14.8x), Philippines (18.3x), Japan (19.3x), Australia (14.7x) and New Zealand (15.9x).

Encouraging economic and political signs make a persuasive case for investing in Malaysia's shares market despite the hurdles that the nation's businesses are likely to encounter in the immediate future. Nevertheless, we urge investors to exercise caution by emphasizing low-beta sectors at the expense of economically-sensitive ones for the time being. After an anticipated economic turnaround in the second half of the year, investors can take a broader strategic approach, accentuating high-beta industries and sectors.

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S&P Index Commentary: We Are Not Alone: The S&P Broad Market Index

There are 46 major global equity markets. S&P Dow Jones Indices combines to create the S&P Broad Market Index (BMI). This benchmark gives investors a picture of the global economy, and they can also scale down to regions and specific counties. Each country comprises major issues that represent the market on an industry level, and investors can also measure market attributions. The BMI is then broken down into two major subgroups: emerging markets (of which there are 20) and developed markets (26). The two groups can be further divided into regional groups, such as pan-Asian or European nations, as well as grouped concept markets, such as the BRICs (Brazil, Russia, India and China). These allow investors to review specific market performances and attributions. Although the U.S. is by far the largest index member, accounting for 45.4% of the global equity market (versus 40.9% in 2007), each market has relevance to the whole, as well as its own features and characteristics.

Table 2

S&P Global Broad Market Index (BMI) Members

	Price change from Dec. 7, 2012	Market value (mil. $)	% of overall market value
Developed markets			
Australia	(7.45)	1,224,580	3.32
Austria	(47.35)	50,210	0.14
Belgium	(37.03)	154,501	0.42
Canada	(9.63)	1,559,060	4.23
Denmark	(0.41)	171,044	0.46
Finland	(53.24)	138,206	0.37
France	(32.96)	1,183,670	3.21
Germany	(26.26)	1,096,520	2.97
Greece	(86.32)	24,226	0.07
Hong Kong	(3.57)	467,013	1.27
Ireland	(48.24)	62,155	0.17
Israel	(16.34)	80,164	0.22
Italy	(59.33)	336,152	0.91
Japan	(21.99)	2,973,060	8.07
Korea	(4.40)	734,651	1.99
Luxembourg	(59.45)	40,110	0.11
Netherlands	(26.71)	347,208	0.94
New Zealand	(9.11)	30,145	0.08
Norway	(24.30)	151,357	0.41
Portugal	(58.00)	32,026	0.09
Singapore	3.03	260,763	0.71
Spain	(50.72)	378,039	1.03
Sweden	12.57	467,463	1.27
Switzerland	11.50	1,112,700	3.02
United Kingdom	(19.34)	2,873,310	7.80

Table 2

S&P Global Broad Market Index (BMI) Members (cont.)			
United States	7.86	16,725,400	45.38
Emerging markets			
Brazil	(21.29)	589,535	1.60
Chile	47.23	113,583	0.31
China	(21.70)	897,808	2.44
Columbia	107.04	67,874	0.18
Czech Republic	(48.13)	12,158	0.03
Egypt	(52.70)	15,343	0.04
Hungary	(51.46)	11,907	0.03
India	(36.35)	355,221	0.96
Indonesia	32.75	144,304	0.39
Malaysia	16.02	144,579	0.39
Mexico	19.80	237,118	0.64
Morocco	(36.27)	10,277	0.03
Peru	43.32	37,728	0.10
Philippines	96.17	72,217	0.20
Poland	(43.80)	66,325	0.18
Russia	(42.39)	298,268	0.81
South Africa	8.24	337,796	0.92
Taiwan	(5.47)	539,042	1.46
Thailand	90.68	138,423	0.38
Turkey	(7.05)	96,626	0.26
Totals			
Emerging subtotals	(13.17)	4,186,132	1,135.66
Developed subtotals	(8.26)	32,673,734	8,864.30
Global BMI	(8.90)	36,859,866	999,996.00
Source: S&P Global Broad Markets Index			

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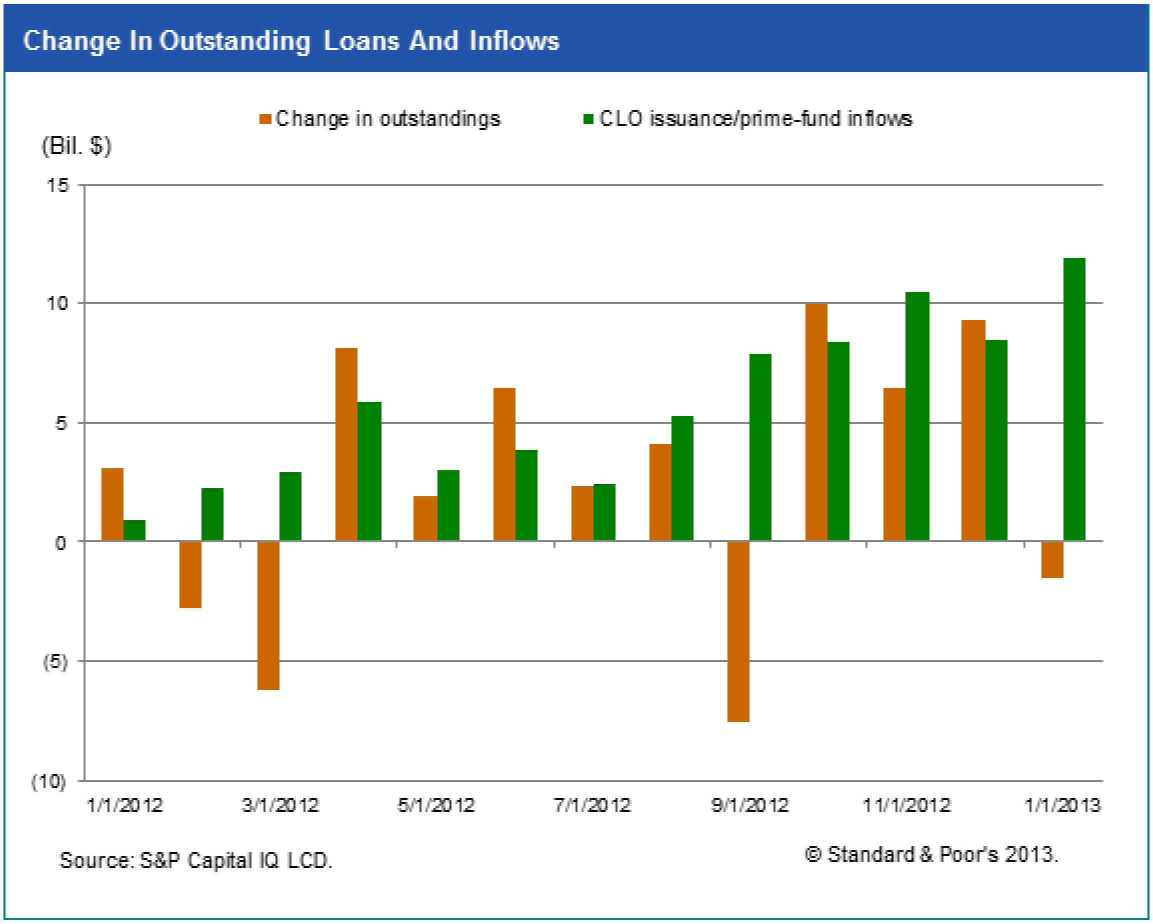
Leveraged Commentary And Data: Hotter Than Hell: January Liquidity Surge Fuels Loan Technical Fire

Loan market technical conditions reached a fever pitch in January, but then cooled slightly in early February, thanks in part to Dell's boost to the forward calendar. Before we examine the latest action, let's review the numbers behind January's technical blowout.

On one side of the equation, supply diminished. In all, the universe of S&P/LSTA Index loans contracted by 0.27% in January, or $1.5 billion, as repayments ran ahead of new-issue volume. On the other side, inflows continued apace.

CLO formation climbed to a post-credit-crunch high of $9.04 billion in January, from $7.3 billion in December (see chart 7). As well, retail investors put $2.9 billion to work in daily- and weekly-access loan funds in January, according to EPFR, up from $1.2 billion in December. All told, roughly $12.8 billion of excess liquidity found its way into the loan market in January, creating a seller's market extraordinaire.

Chart 7



And, participants say these data understate the case, because they don't include what managers describe as a steady--though unquantifiable--stream of allocations from pension funds and other institutional investors into the space.

No matter. January's massive liquidity injection put issuers and sellers firmly in the driver's seat, as the stats in table 3 illustrate:

Table 3

Market Snapshot

	January 2013	December 2012	2012 monthly average	February 2011	Lowest/highest since
Average New-Issue Yield (%)					
BB	3.48	4.19	4.58	4.30	Record
B	5.02	5.69	6.52	5.34	Record
Average New-Issue All-In Spread					
BB/BB- (L+)	328	378	430	409	6/30/2008
B+/B (L+)	459	566	604	495	12/31/2007
% of breaks flexed down	78	47	39	69	9/30/2005
% of breaks flexed up	0	26	21	2	1/31/2010
Average call premium period (months)	10	13	16	12	N.A.
% cov-lite	54	52	28	27	Record

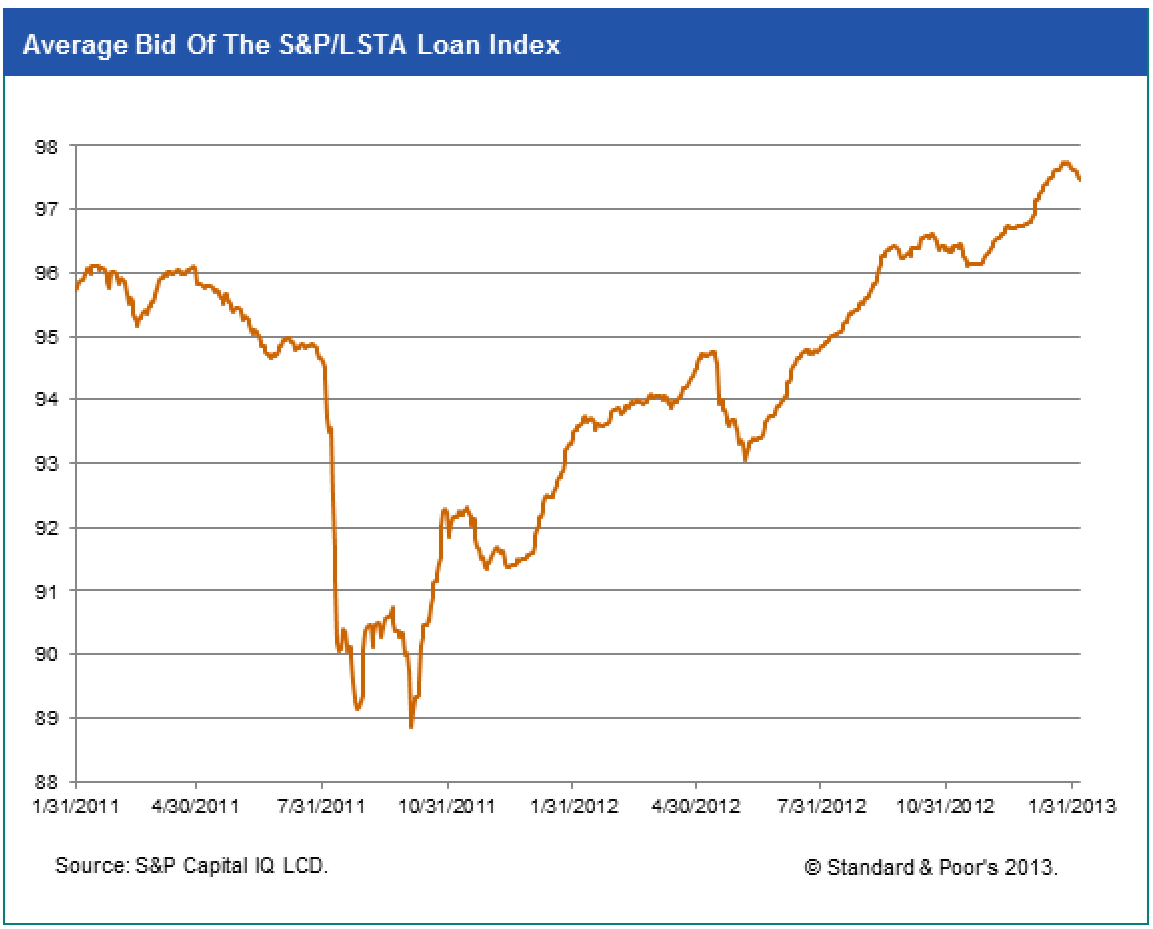
Table 3

Market Snapshot (cont.)					
Average OID (%)	99.64	98.99	98.76	99.70	3/31/2011
Average break price (%)	100.79	99.94	99.69	100.66	4/30/2006
Repricing volume (bil. $)	44.0	4.8	6.0	28.7	2/28/2007
Average secondary price					
S&P/LSTA Index loans	97.65	96.78	94.93	96.02	7/26/2007
Performing loans	98.01	97.29	95.60	97.19	7/25/2007
S&P/LSTA Index all-In yield ($)*	5.44	5.59	5.97	4.98	7/31/2011
S&P/LSTA Index all-in spread (L+)*	516	529	560	468	7/31/2011

*Excludes defaulting loans. N.A.--Not available. Source: S&P Capital IQ LCD

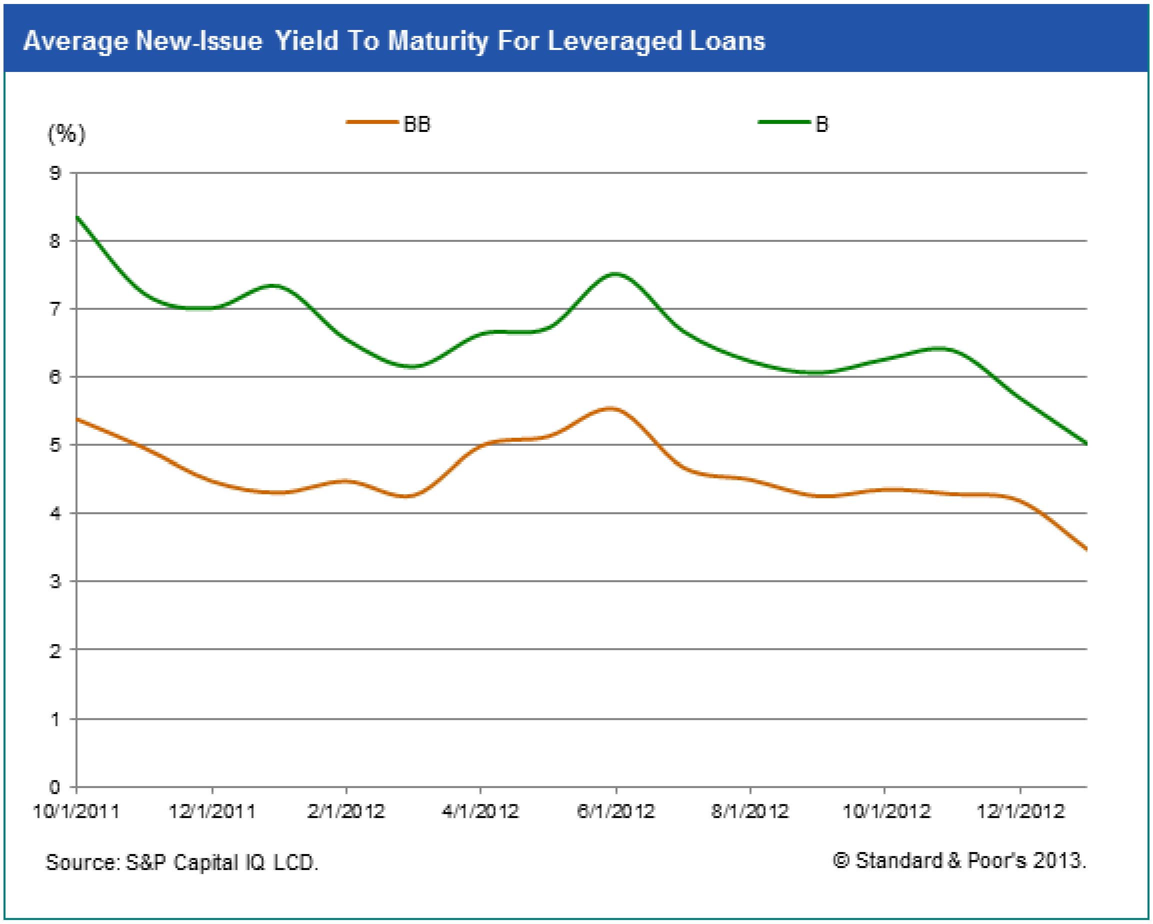
In early February, the market reached, if not an inflection point, then at least a stationary point, with primary and secondary levels flatlining at what clearly remain bull-market readings. For instance, after gaining 1.06% in January, the S&P/LSTA Index inched down 0.09% during the first week of February, as the average bid eased to 97.46 on Feb. 7, from a post-credit-crunch high of 97.73 on Jan. 28 (see chart 8). Of course, the slight pullback in the secondary is due in part to the fact that investors reeled in bids for loans trading above their call prices, motivated by the potential for a repricing/refinancing rather than the yield on offer.

Chart 8



Likewise, new-issue yields in early February were consistent with those in January (see chart 9).

Chart 9

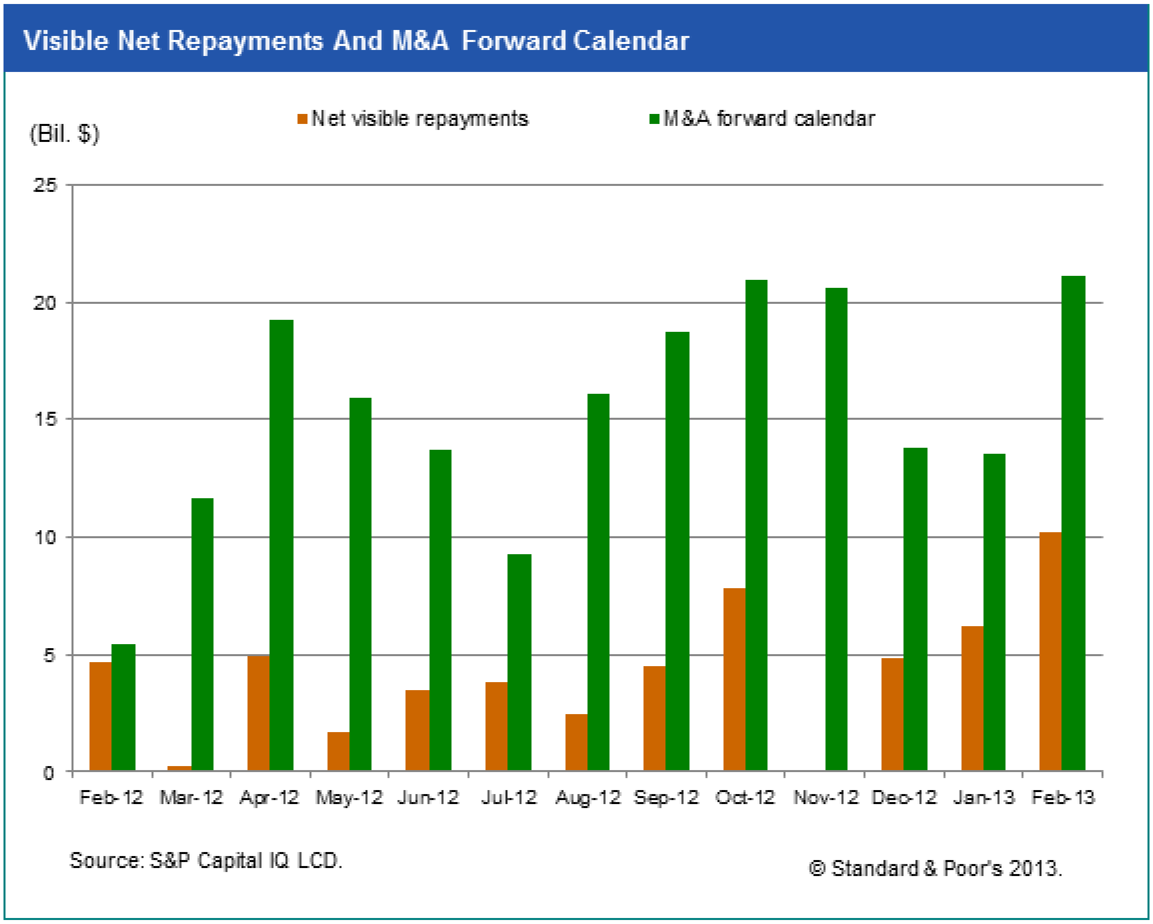


In part, these trends reflect the fact that the dial was already turned up to 11 in January, the highest point even on Spinal Tap's amps. As well, investor fatigue has set in after 2012's massive burst of repricing activity, which has shaved 112 basis points (bps), on average, from $73 billion of institutional loans as of Feb. 8. To put these numbers in context, issuers have cut the spread on 11% of S&P/LSTA Index loans so far in 2013, reducing, on a pro forma basis, the average secondary spread of the Index by 12 bps. Finally, a subtle shift in the market's technical plates helped stabilize yields. Here's how:

On the supply side of the ledger, the announcement of the long-awaited $24 billion Dell leveraged buyout (LBO) put $5.5 billion of new funded loan paper--the largest institutional execution since 2007--on the calendar, courtesy of a $4 billion regular-way B loan and a $1.5 billion, five-year C loan designed to appeal to legacy collateralized loan obligations (CLOs). Add to Dell billion-dollar-plus financings for Virgin Media and Scientific Games, and the all-important visible pipeline of M&A-related loans jumps to $21.1 billion on Feb. 6, from $13.5 billion a week earlier and $12.3 billion at year-end.

At the same time, the net amount of visible repayments that Leveraged Commentary & Data (LCD) tracks rose more modestly, to $10.2 billion as of Feb. 6, from $6.2 billion a week prior and $4.8 billion in early January. That implies that the amount of net supply on the calendar--M&A-related loans less visible repayments--stands at $10.9 billion, up from $7.3 billion at the end of January and $9 billion at year-end (see chart 10).

Chart 10



On the other side of the supply/demand equation, conditions weakened slightly in early February as CLO issuance hit a speed bump. That's not to say the market's not still rocking--it is. With the American Securitization Forum conference taking most participants off the desk in late January, there was just one new CLO print during the first week of February--Sankaty's $522 million Race Point VIII CLO--bringing the year-to-date tally to $9.6 billion. In 2012, CLO issuance didn't hit that level until April.

But the sharp contraction in new-issue clearing yields has made arbitrage less compelling, and participants speculate that it may slow the progress of boutique managers that don't have a ready way to ramp portfolios outside of a warehouse. After all, the average new-issue clearing print was 39 bps lower for 'BB' rated loans and 94 bps lower for 'B' rated loans in February than in December. As well, the average discounted secondary spread of the S&P/LSTA Index narrowed by 14 bps to L+515. At the same time, the tightest CLO 'AAA' print of 2012 (Sankaty) was L+125, or 17 bps inside December's average. Managers say that spreads are heading lower still, perhaps to L+120 for managers with the strongest call into investors.

But until supply becomes more plentiful, players think the pace of CLO formation may downshift from that of the past three months, when managers printed $8.3 billion per month, on average.

That's not to say that inflows are drying up. At least for February, managers expect to see another $5 billion to $6 billion of CLOs that are already in the works get across the goal line. But managers speculate that volume could fall more profoundly in March unless loan supply expands, driving collateral spreads wider.

Retail investors, meanwhile, continue to embrace the asset class as a unique way to reduce credit and interest rate risk without either buying equities or completely forgoing current distributions. Indeed, inflows to daily- and weekly-reporting funds soared to a record $1.1 billion during the week ended Feb. 5, according to EPFR. That follows a 20-month-high haul of $2.9 billion in January.

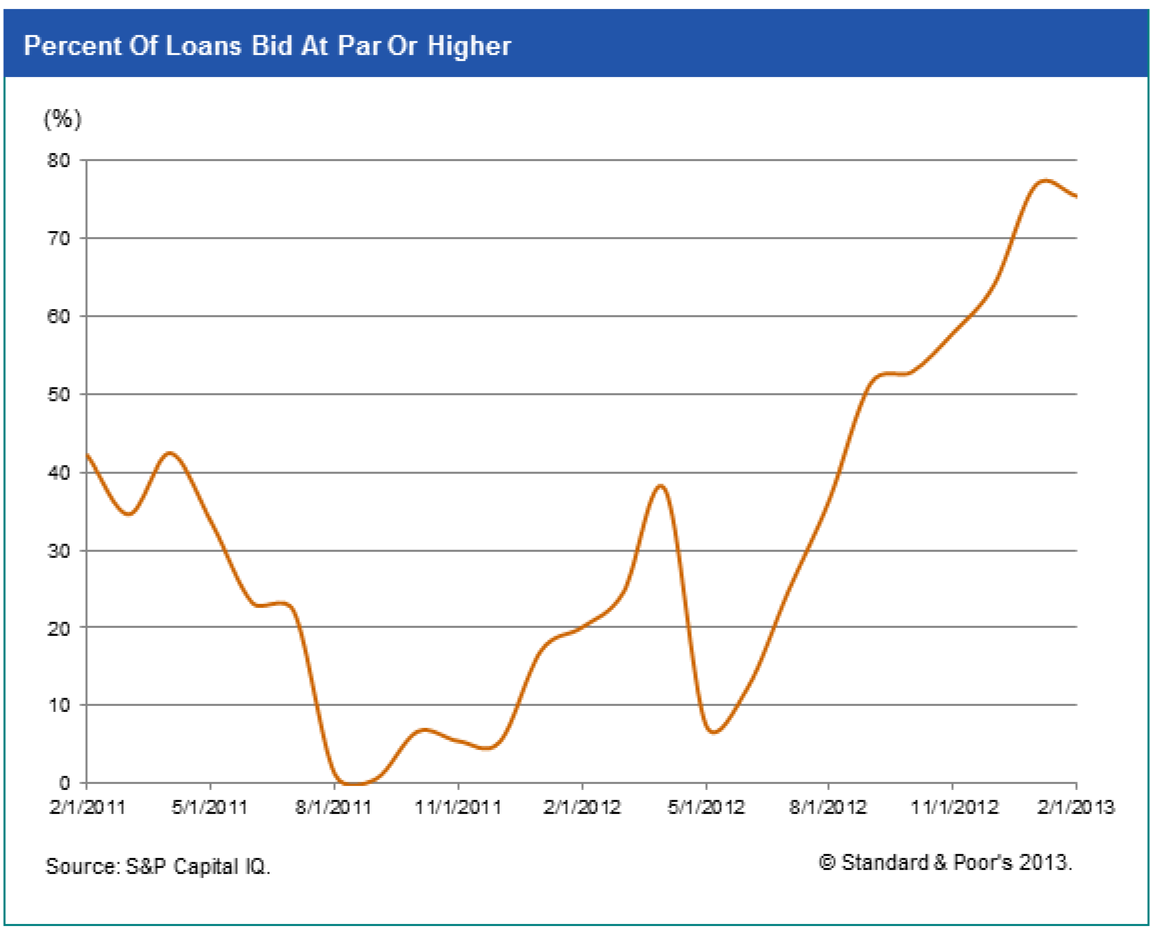
Likewise, managers say pension funds and other institutional investors are putting perhaps $2 billion a month to work in loans as a way to reduce duration and interest rate risk.

Add it up and managers expect to see capital flows into the loan asset class slow to maybe $10 billion a month, give or take--$2-3 billion of retail, $2 billion of institutional, and $4billion to $6 billion of CLOs--from $13.5 billion, assuming, again, $2 billion of separate account allocations from pension funds.

However, the small increase in supply and decrease in demand may not be sufficient yet to derail the repricing train. Already in February, 31 issuers have announced $27 billion of spread-shaving exercises. But, with the market cooling, accounts are drawing lines in the virtual sand. DuPont Performance Coatings was the buyside's first major win here. The Carlyle-backed issuer on Monday abandoned an effort to reduce the pricing of its $2.3 billion covenant-lite LBO loan from late January to roughly 4% (L+300/1% floor), from 4.75% (L+350/1.25%), in exchange for a 101 payout.

Looking ahead, the field of repricing candidates in the S&P/LSTA Index is large. As of Feb. 8, $408 billion of Index loans, or 75% of overall outstandings, were bid at par or higher (see chart 11). Drilling down to loans that are through their prepayment fee period, that number drops to a still-muscular 38%.

Chart 11



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R2P Corporate Bond Monitor

The U.S. Commerce Department's recent announcement that America's trade deficit shrank in December to its narrowest point in nearly three years suggests that the U.S. economy likely expanded slightly in the fourth quarter as higher exports and a slump in oil imports narrowed the trade gap. Although the GDP report indicated a fourth-quarter contraction of 0.1%, shocking economists looking for an expansion of 1.1%, we think this figure could be misleading. The fourth quarter included an expected drop in exports, smaller gains in inventories and a plunge in government spending on the military. The apparent contraction in GDP was the result of these factors--particularly the fluctuating defence spending--and they disguised the good progress in the private sector.

Conversely, eurozone output declined again in January despite strength in Germany. The bloc's purchasing managers' index (PMI) rose to 48.6 from 47.8 in December, but remains below 50, the level that indicates no change. The improvement was because of Germany, which posted a 19-month PMI high of 54.4, up from 50.3. On the other hand, France saw its PMI fall significantly to a 46-month low of 42.7 from 44.6.

Against mixed economic reports, risk-reward profiles--as measured by average Risk-to-Price (R2P) scores--improved across the board in North America and remained unchanged in Europe from Jan. 28 to Feb. 8 (see tables 4 and 5). Yield increased in the two regions, but the more noticeable credit and market risk declines were seen in North America.

In North America, scores overall improved by 5% as a result of a decrease in the average probability of default (PD) of 5%, a decrease in the 20-day historical bond price volatility of 4%, and a widening in the average option-adjusted spread (OAS) of 5 basis points (bps).

In Europe, scores remained unchanged, on average. PDs showed no change, but average bond price volatility decreased 5%, and the average OAS widened by 8 bps.

Table 4

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

	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	2	5	(10)	(4)
Consumer staples	2	(3)	(14)	(7)
Energy	4	11	27	3
Financials	2	(1)	(18)	(3)
Health care	14	8	0	(8)
Industrials	3	8	(5)	(2)
Information technology	4	13	1	(5)
Materials	(3)	8	(9)	(5)
Telecommunication services	17	10	(11)	(8)
Utilities	4	(5)	(13)	(5)

Change as of Feb. 8, 2013, from Jan. 28, 2013. Sourc:e: S&P Capital IQ.

Table 5

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

	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	(5)	(6)	5	(10)

Table 5

European Risk-Reward Profiles By Sector--Average R2P Score And Components Changes (cont.)				
Consumer staples	1	(1)	7	6
Energy	(23)	8	16	3
Financials	6	7	(31)	(7)
Health care	14	7	(17)	(15)
Industrials	3	5	(8)	(9)
Information technology	2	30	22	5
Materials	2	17	5	2
Telecommunication services	(7)	9	10	(6)
Utilities	8	3	(11)	(16)

Change as of Feb. 8, 2013, from Jan. 28, 2013. Sourc:e: S&P Capital IQ.

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Market Derived Signal Commentary: Credit Market Thinks Ireland Is Headed In The Right Direction

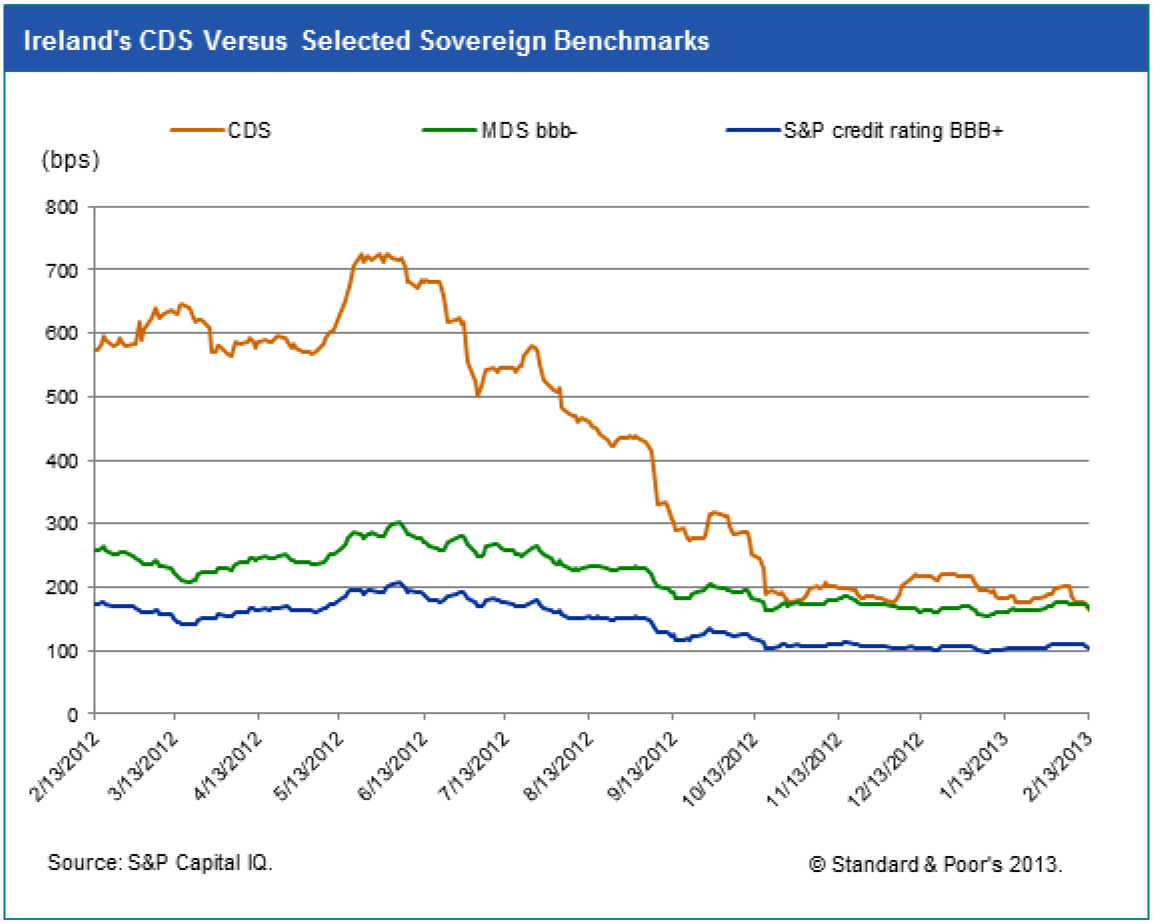
Standard & Poor's Ratings Services acknowledged Ireland's success in turning around its once dire fiscal position when it revised the country's outlook to "stable" from "negative" on Feb. 11, 2013 (see "Ireland Outlook Revised To Stable On Promissory Notes Exchange; 'BBB+/A-2' Ratings Affirmed"). The analysts approved of Ireland's recent agreement to exchange promissory notes to Irish Bank Resolution Corp. for Irish government bonds with long maturities, which should lower the government's debt-servicing costs and refinancing risk. "We believe the success of the exchange increases the likelihood of a full return by Ireland to private financing and, therefore, of Ireland successfully exiting the EU/IMF bailout program, at the end of 2013." Standard & Poor's also indicated that it would consider a higher rating for the country "if the government sustains its fiscal strategy." In addition to paying down debt, the government's ability to sell its large equity stake in domestic banks to investors outside of Ireland would be considered a "positive for the ratings."

At present, Standard & Poor's has a 'BBB+' rating on Ireland, and this reflects its view of "the government's commitment to stabilizing Ireland's public finances, as well as the high wealth, openness, and resilience of the Irish economy which we assess as more flexible than most of its eurozone peers." At the same time, significant fiscal deficits, large debt loads, and a weak financial system moderate the country's strengths.

In the two days following this action, the country's five-year credit default swap (CDS) spread tightened 7.3% to 164 basis points (bps), a level not seen since April 22, 2010, according to S&P Capital IQ. But investors appeared to have already approved the promissory note exchange and anticipated the ratings action; year to date the spread is 19% tighter than it was on Jan. 2. Over the past year, the insurance premium has contracted 71% from its widest point of 725 bps on May 21, 2012. The spread reached its widest point in history, 1,287 bps, on May 13, 2010.

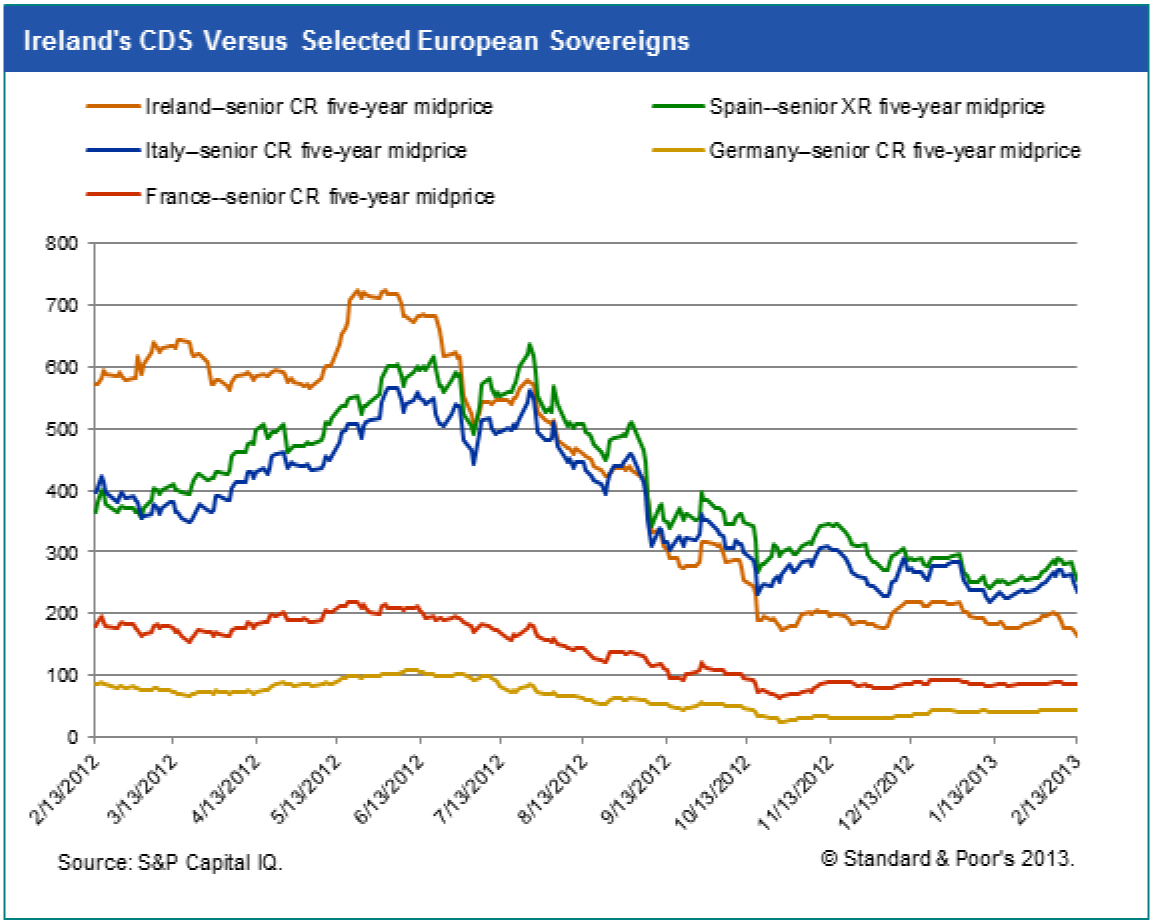
On Feb. 13, Ireland's CDS broke through its Market Derived Signal benchmark of 'bbb-' and is heading toward Standard & Poor's 'BBB+' credit rating (see chart 12). The difference between Ireland's spread and the credit rating benchmark is now 59 bps, a tightening of 8 bps over the past two days.

Chart 12



Ireland has distanced itself from the financially riskier countries of Spain and Italy, which have made less progress in restoring their fiscal strength, but the country has a way to go to be in the same company as France and Germany (see chart 13).

Chart 13



Nevertheless, the credit market's view of Ireland as a high-risk sovereign has changed remarkably. Ireland's CDS spread should maintain its level and may perhaps continue to tighten, as long as the country persists in its quest for greater financial strength.

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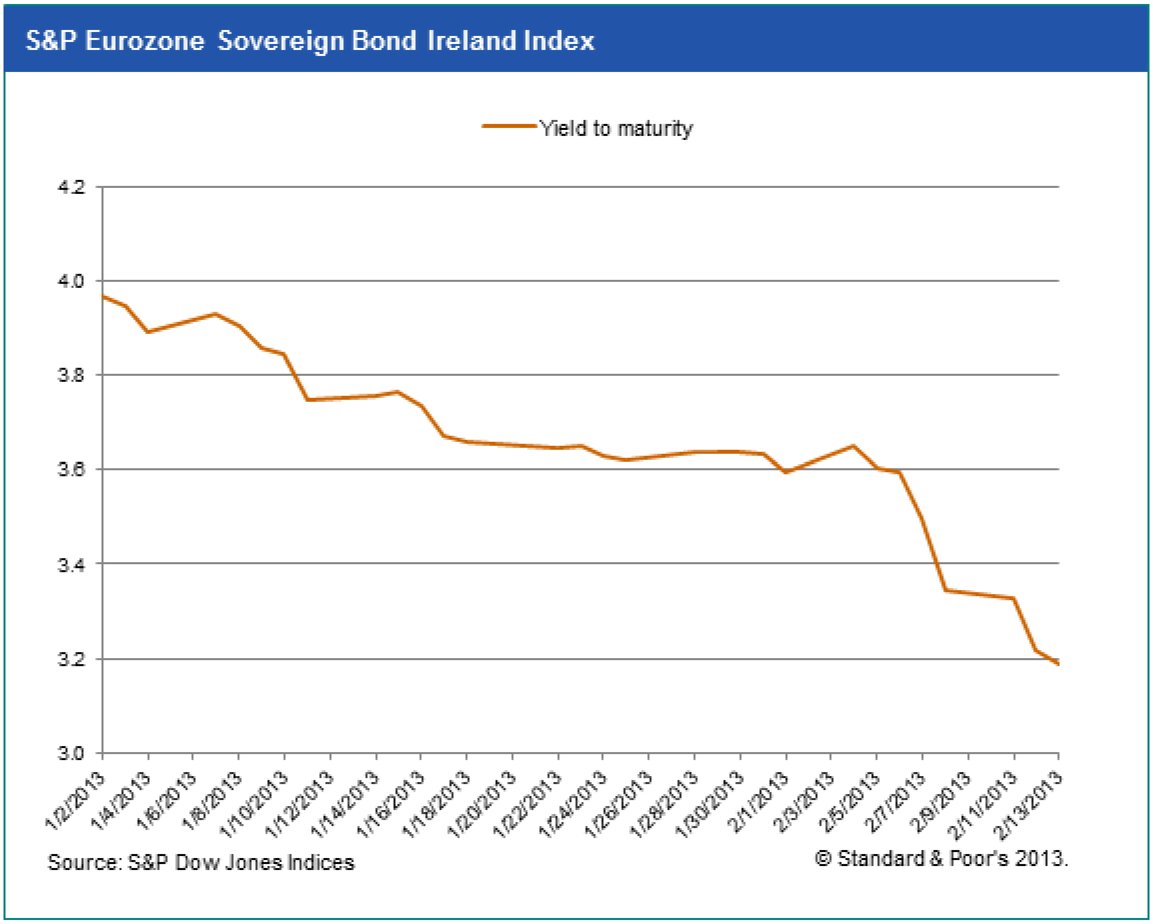
Market Commentary: Eurozone Sovereign Debt: Irish Eyes Are Smiling

Last week, the European Central Bank (ECB) left its benchmark interest rate unchanged at 0.75% and bonds rallied after European economic news caused investors to return to the safety of U.S. Treasuries. The yield of the S&P Eurozone Sovereign Bond Index remained relatively unchanged.

Mixed in with all the daily market commentary was a bright spot for one of the member countries of the S&P Eurozone Sovereign Bond Index. It's not St. Patrick's Day, it's not even March, but Irish luck prevailed--Ireland won a key victory by refinancing the debt package that funded its broken banks (Anglo Irish Bank Corp. and Irish Nationwide). The refinancing plan calls for the swapping of €25 billion in current promissory notes into long-term bonds with maturities as far out as 40 years. The deal could ease the country's borrowing by as much as €20 billion as the rates on the loan go from 8% to 3% floating. The deal is cause for hope that Ireland can successfully exit the bailout provisions by the end of 2013, and bond investors are speculating on a possible ratings upgrade in the near future. Year to date, the yield on the S&P Eurozone Sovereign Bond Ireland Index has tightened by 78 basis points (see chart 14), with index total return at

5.21%.

Chart 14



The only other component country of the S&P Eurozone Sovereign Bond Index with returns greater than Ireland, both month to date (MTD) and year to date (YTD), is Cyprus. Like Ireland, Cyprus is a small percentage of the overall index, but its bonds have been performing well (see table 6). The S&P Eurozone Sovereign Bond Cyprus Index is returning 4.9% MTD and 23% YTD. Cyprus bond prices have remained steady despite recent reports of angry mobs storming banks and a rise in inflation to 1.8%. The Cyprus government has a €1.4 billion bond maturing in June (3.75% 6/3/2013) along with additional needs estimated at just under €20 billion. These monetary needs are being closely scrutinized by other eurozone countries and the general public.

Table 6

S&P Eurozone Sovereign Bond Indices

	Ticker	Number of issues	% of Index	Index value as of 2/13/13	Total return rate month to date (%)	Total return rate year to date (%)
Eurozone	SPBDEGIT	294	100.00	195.67	(0.07)	(0.53)
Austria	SPBDEATT	18	4.18	98.53	(0.13)	(1.47)
Belgium	SPBDEBET	24	6.64	98.20	(0.14)	(1.80)
Cyprus	SPBDECYT	2	0.04	122.78	4.85	22.78
Finland	SPBDEFIT	12	1.50	98.02	0.05	(1.98)
France	SPBDEFRT	41	23.18	98.18	(0.26)	(1.82)

Table 6

S&P Eurozone Sovereign Bond Indices (cont.)						
Germany	SPBDEDET	47	19.98	98.10	0.04	(1.90)
Ireland	SPBDEIET	9	1.84	105.21	2.53	5.21
Italy	SPBDEITT	54	22.89	101.28	(0.30)	1.28
Luxemburg	SPBDELUT	2	0.07	97.43	0.14	(2.57)
Netherlands	SPBDENLT	20	6.23	97.68	(0.15)	(2.32)
Portugal	SPBDEPTT	12	1.86	103.02	(0.21)	3.02
Slovakia	SPBDESKT	13	0.54	99.34	0.08	(0.66)
Slovenia	SPBDESIT	9	0.25	101.47	(0.00)	1.47
Spain	SPBDEEST	31	10.81	101.99	0.29	1.99

Source: S&P Dow Jones Indices

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

IPOs

Less than halfway through the first quarter of 2013, evidence is suggesting that it's going to be a strong year for underwriting fees from initial public offerings. According to S&P Capital IQ data, underwriters' compensation from IPOs priced on major US exchanges, including closed-end funds and real estate investment trusts, totaled $420.5 million as of Feb. 13, up 229% from $127.7 million for the same period in 2012. Furthermore, this year's showing so far is the best since 2007 when for the equivalent year-to-date period underwriters earned $540.6 million from the completion of 25 issues (see table 7).

The findings show the robust state of capital markets at this time and point toward prospective healthy earnings for the financial sector this quarter. Contributors to the year-to-date fee totals include the $2.24 billion IPO by Zoetis Inc., which generated $82.8 million in underwriting fees, and CVR Refining LP's $600 million issue, which saw $30 million in underwriters' compensation.

Table 7

U.S. IPOs - Underwriters' Fees		
Effective dates	**Volume (mil. $)**	**Number of issues**
1/1/2007 to 2/13/2007	540.6	25
1/1/2008 to 2/13/2008	14.5	4
1/1/2009 to 2/13/2009	36	1
1/1/2010 to 2/13/2010	121.9	12
1/1/2011 to 2/13/2011	392.8	26
1/1/2012 to2/13/2012	127.7	18
1/1/2013 to 2/13/2013	420.5	18

Source: S&P Capital IQ

M&A

Since the announcement earlier this month that Dell Inc. was intending to go private in a $29.8 billion leveraged buyout (LBO), several voices opposing the deal have emerged. Southeastern Asset Management Inc., which beneficially owned an aggregate 7.48% (130 million) of Dell shares outstanding as of Sept. 30, 2012, started a campaign against the deal by sending a letter to Dell's board of directors expressing the view that the proposed transaction grossly undervalues the company, and indicating that they will not vote in favor of the transaction as it is currently structured.

Yet, if history serves as a guide, the likelihood of the transaction being canceled seems to be small. According to S&P Capital IQ data, there have only been five cases of an announced global LBO worth more than $20 billion being subsequently canceled (see table 8). Assuming there are no modifications or revisions, we expect the transaction to close before the end of the second quarter of Dell's fiscal year 2014, which is July 2013.

Table 8

Canceled LBOS Worth More Than $20 Billion

Announced date	M&A Canceled date	Target	Total transaction value (mil. $)	Buyer(s)/investor(s)
12/21/2007	12/11/2008	BCE Inc.	48,803.42	Madison Dearborn Partners LLC, Providence Equity Partners LLC, Teachers' Private Capital, Merrill Lynch Capital (investment arm)
2/27/2008	3/4/2008	Inmobiliaria Colonial SA	20,136.97	Investment Corp. of Dubai
4/15/2007	1/25/2008	SLM Corp.	21,049.66	Friedman Fleischer & Lowe LLC; North Cove Partners; J.C. Flowers & Co. LLC; JPMorgan Investment Advisors Inc.
10/10/2006	10/24/2007	Cablevision Systems Corp.	21,098.01	Investor Group
4/16/2006	4/16/2006	BAA Airports Ltd	27,398.20	Goldman Sachs Group (merchant banking division)

Source: S&P Capital IQ.

Debt

The first full week of February saw reduced demand for security identifiers associated with several debt-related issues. According to CUSIP Global Services, identifier demand fell by more than half in the past week after downturns in domestic corporate debt and private placement number CUSIP orders. Despite this recent development, year-to-date aggregate CUSIP activity among the various debt security classes listed below (see table 9) is up more than 16% from year ago levels. There may be a couple of early signs of what's in store for financing activity in the rest of the year. The increase in M&A activity in early 2013 may have contributed to the jump of more than 29% in domestic corporate debt CUSIP request, after acquirers started trying to raise capital. Secondly, the early drop in municipal CUSIP orders, a contrast to the increase this time last year, may suggest that as some states and localities show fiscal improvements demand for financings has eased.

Table 9

Selected Debt Securities CUSIP Requests

	Week ending 2/8	Week ending 2/1	2013 year to date	2012 year to date	Year over year change (%)
Domestic corporate debt	113	589	1479	1145	29.17
Municipals	294	270	1370	1426	(3.93)
Short-term muni note	18	34	131	140	(6.43)
Long-term muni note	10	14	43	27	59.26
International debt	54	52	288	145	98.62
PPN domestic debt	31	136	299	218	37.16
Total	520	1095	3610	3101	16.41

Source: CUSIP Global Services

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S&P Index Commodity Commentary: Positive Sentiment Helps, Despite The Weather

Commodities are mixed this month. The S&P GSCI is up 18 basis points (bps) for a year to date (YTD) performance of 4.55% through Feb. 13, 2013, and the DJ-UBSCI is down 1.33%, reducing its YTD performance to 1.03%. Energy has continued to benefit from promising economic data from China and the U.S., but agriculture has suffered due to favorably wet growing conditions that have driven down prices.

Energy

The energy sector this month has helped to support the indices with the S&P GSCI Energy up 1.51% and the DJ-UBSCI Energy up 0.56%. The sector's performance and weighting in the DJ-UBSCI was not enough to keep the overall index positive for the month, but it did drive the overall positive performance of the S&P GSCI.

The Oil Market Report, released on Feb. 13 by the International Energy Agency (IEA), showed oil futures prices reached nine#month highs early this month. Improved economic signals from China and the U.S. combined with colder temperatures to improve market sentiment. Month to date (MTD), the S&P GSCI Brent Crude Oil was up 2.92% and the DJ-UBSCI Brent Oil was up 2.91%.

Although the sentiment was positive, the IEA cut its demand forecast for 2013 by 90,000 barrels per day (bpd). This was in contrast to the report by the U.S. Energy Information Administration (EIA) that increased its forecast for demand growth by 110,000 bpd to 1.05 million bpd in 2013. Also, the Organization of Petroleum Exporting Countries (OPEC) on Tuesday, Feb. 12, raised its estimates for global oil demand, citing signs of a recovery in the global economy, and now expects 89.68 million bpd to be sold this year, up from 89.55 million estimated in January.

Further, prices were supported by statements from the IEA that Iranian oil exports will likely continue to decrease as the West tightens sanctions on Tehran. According to the report, exports from Iran have already fallen to their lowest level in 30 years. Finally, the report stated that in January, global supplies fell by 300 kb/d (thousand barrels per day) with non#OPEC production slipping by 190 kb/d and OPEC crude supply hitting 12#month lows of 30.34 mb/d (million barrels per day), despite slightly higher output in Saudi Arabia and Kuwait. The IEA cut the call on OPEC crude and stock change for first-quarter 2013 by 100 kb/d to 29.7 mb/d.

Agriculture

Despite the positive economic sentiment, the too-favorable weather for wheat, corn, and soybeans has caused the agriculture sector to be the worst performer of the month. The S&P GSCI Agriculture was down 4.88% and DJ-UBSCI Agriculture was down 4.38% through Feb. 13.

Corn prices fell for the longest losing streak in five and a half years as South American weather improved. Also, weather conditions in the U.S. continued to boost prospects for wheat and soybeans. Further driving soybeans down are forecasts for rain next week in Argentina. On Feb. 8, the U.S. Department of Agriculture (USDA) forecasted better-than-expected global supplies of corn and soybeans in the coming months, also lending to the fall in prices.

The mono indices of Corn, Chicago Wheat, Kansas Wheat, and Soybeans in both the S&P GSCI and DJ-UBSCI were down 6.28%, 5.54%, 6.82% and 2.88%, respectively, through Feb. 13.

Table 10

Index Performance (Total Return*) Sorted By Year To Date (%)

	One week	Month to date	Year to date	12 months	Three years	Five years
DJ-UBSCI Yen	(1.44)	1.04	9.20	16.86	11.69	(37.13)
S&P WCI	0.89	1.95	6.32	4.43	57.21	(5.08)
DJ-UBSCI Pound Sterling	(0.67)	0.63	5.64	(1.66)	8.22	(8.08)
S&P GSCI Multiple Contract	0.12	0.25	4.59	(0.56)	21.60	(29.53)
S&P GSCI	0.06	0.18	4.55	(0.18)	21.07	(33.00)
S&P GSCI Enhanced Commodity	0.14	0.20	4.49	(0.51)	26.14	(17.44)
S&P GSCI 3 Month Forward	0.19	0.30	4.44	(2.10)	24.16	(17.34)
S&P GSCI Dynamic Roll	0.13	0.63	2.83	(0.31)	23.25	(1.78)
S&P GSCI Light Energy	(0.89)	(1.28)	1.82	(0.72)	20.29	(25.34)
S&P SGMI	1.14	1.32	1.28	(13.61)	15.48	37.03
DJ-UBSCI 3 Month Forward	(1.25)	(1.24)	1.07	(4.02)	13.29	(14.67)
DJ-UBSCI	(1.35)	(1.33)	1.03	(3.21)	7.55	(27.19)
DJ-UBSCI 2-4-6 Forward Blend **	(1.18)	(1.15)	0.89	(3.50)	15.64	(13.25)
DJ-UBSCI Roll Select	(1.14)	(1.02)	0.86	(3.43)	15.90	(11.84)
S&P DFI	0.08	0.04	0.35	(10.67)	(15.22)	(15.15)
S&P GSCI Covered Call Select	(1.81)	(2.27)	0.14	(6.91)	6.23	(11.83)
DJ-UBSCI Euro	(0.61)	(0.32)	(0.87)	(4.79)	8.94	(21.08)
S&P GSCI Dynamic Roll Alpha Light Energy*	(0.00)	0.14	(1.16)	(1.13)	3.66	24.68

*S&P GSCI Dynamic Roll Alpha Light Energy is excess return because the market neutrality negates collateral return. **Dow Jones-UBS Commodity 2-4-6 Forward Blend is a weighted return index. Data is total return through Feb. 13, 2013. Charts and graphs are provided for illustrative purposes only. Indices are unmanaged statistical composites and their returns do not include payment of any sales charges or fees an investor would pay to purchase the securities the index represents. Such costs would lower performance. It is not possible to invest directly in an index. Past performance is not an indication of future results. Source: S&P Dow Jones Indices.

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