S&P CAPITAL IQ

Lookout Report
from Global Markets Intelligence

Three Key Economic Topics To Follow Closely In 2012: Jobs, Housing, And Sovereign Risk

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.

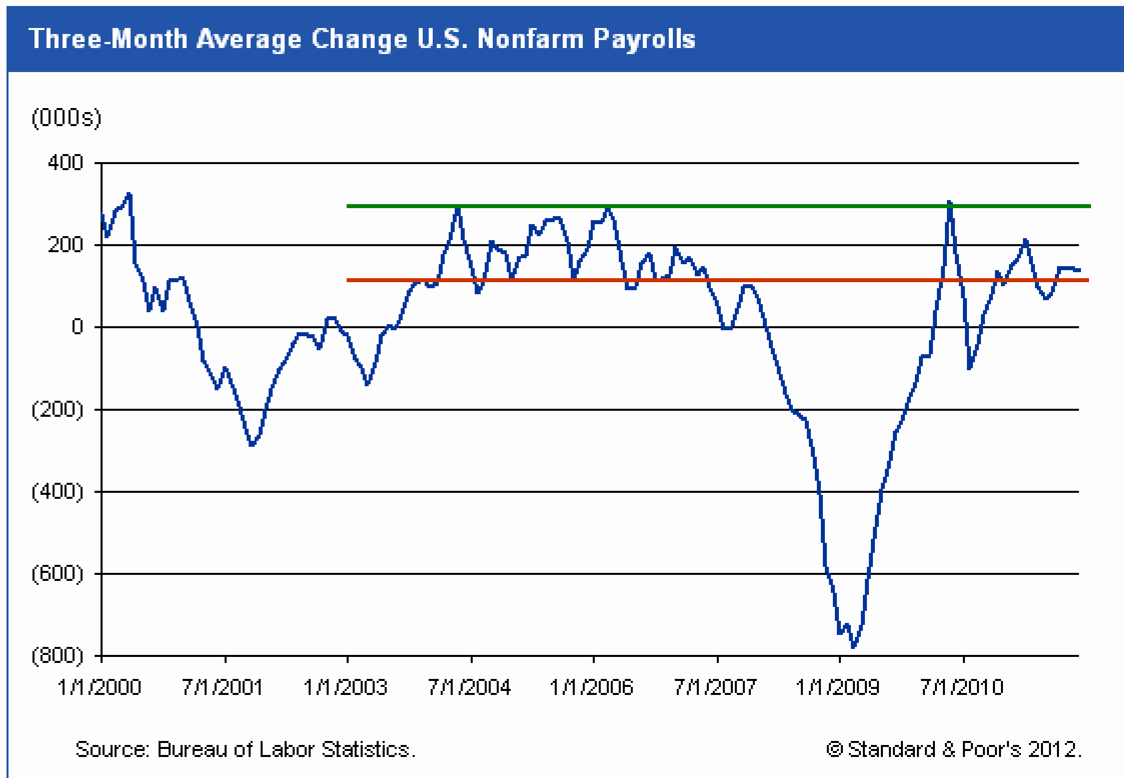
In our previous Lookout Report, the first of 2012, we concluded that while we remain optimistic for the economy and markets in 2012, we will continue to monitor the underlying conflict between improving macroeconomic fundamentals and simmering sovereign and financial system credit risks. The three-year-old U.S. economic recovery has been weak by historical standards, in large part because of the complex and interrelated drags resulting from subpar employment growth and ongoing stagnation in the housing market. The recovery, in summary, seems to lack a normal degree of consumer and business confidence. Global financial system contagion risks, as a consequence of sagging sovereign credit quality, represent a more significant threat to economic growth than if the U.S. economy had a healthier and historically normal post-recession recovery.

At the start of 2012, the Global Markets Intelligence (GMI) research team has continued to monitor three particular indicators to gauge how factors that dominated the second half of 2011 are evolving in the current year (see "Lookout Report: Once Again, We Are Cautiously Optimistic At The Start Of The New Year," published Jan. 6, 2012, on the Global Credit Portal). These key issues are the rate of U.S. job creation, the prospects for an upswing in the U.S. housing market, and the level of market concern regarding sovereign credit quality and the associated global financial risks.

Jobs

Healthy global GDP growth would improve sovereign credit profiles and buy time for policymakers to implement necessary fiscal reforms, while sagging growth would feed investor anxiety and preference for risk aversion. From our perspective, we believe that the rate of employment creation in the world's largest economy (the U.S.) is the most significant indicator for determining whether 2012 will be a risk-on or risk-off year. U.S. nonfarm payroll growth averaged between 100,000 and 300,000 during the 2003 to 2007 portion of the prior economic recovery, but has sustained little, if any, strength during the current recovery (see chart 1).

Chart 1

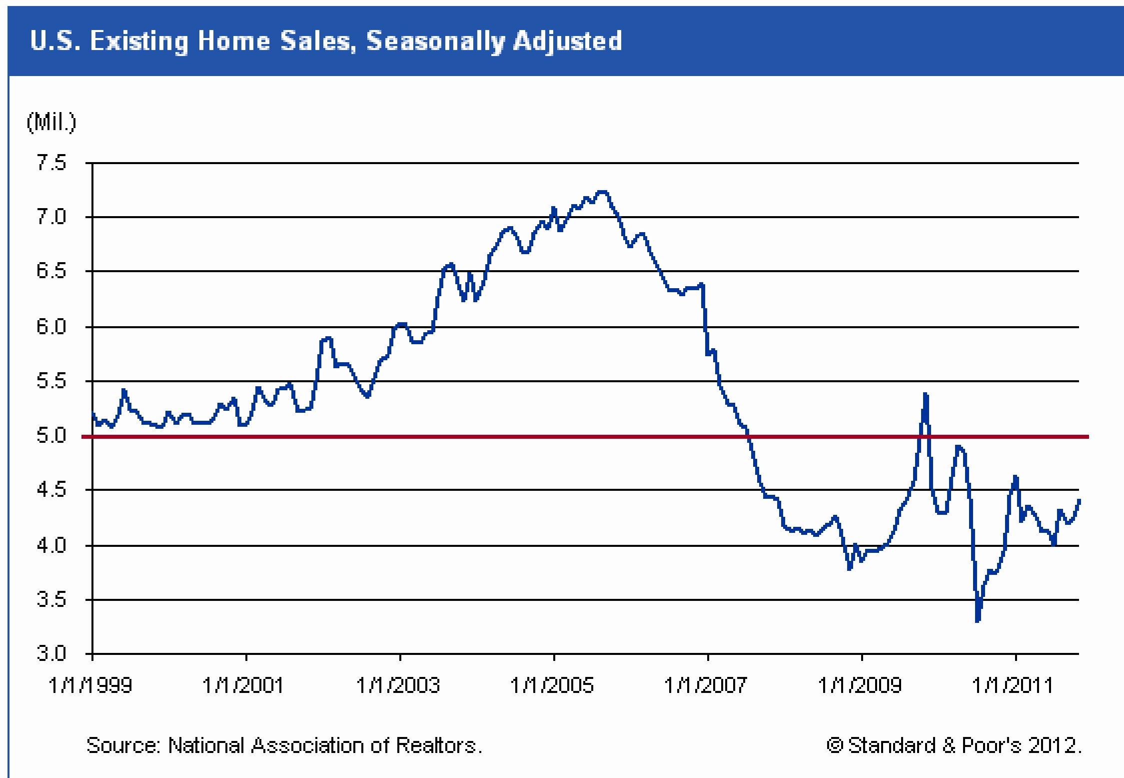


The extent that the pace of job creation in 2012 can repeat the prior four-year period of sustained payroll growth will have an outsized influence on 2012 global GDP growth and financial market performance, in our opinion. The three-month average rate of payroll growth currently stands at an improved (but still meager) 137,000 as of December, leaving much room for improvement in 2012, within a range of 150,000 to 250,000, according to the historical record.

Housing

The near total lack of recovery in the U.S. housing market continues to be a significant drag on the current GDP growth cycle (see chart 2). The weak housing market is a severe headwind to housing-related consumer activity such as appliance, electronics, furniture, and home improvement purchases. In addition, the weak housing market stunts GDP growth as a result of the deficit of employment opportunities created in the construction, home improvement, and realty labor markets.

Chart 2



GMI Research continues to believe that sustained robust nonfarm payroll growth will benefit the depressed state of affairs in the U.S. housing market as consumer confidence and income firepower improves lockstep with a declining U.S. unemployment rate. However, we are mindful that this is not the first time we have published this belief, having previously made a similar statement in November 2010. The outlook for an improving U.S. employment situation and recovery in housing looked to be on track in the spring of 2011, until the multiple disasters in Japan and the emergence of the U.S. economic "soft patch" drove the U.S. unemployment rate higher to 9.2% in June 2011 from 8.8% in March 2011.

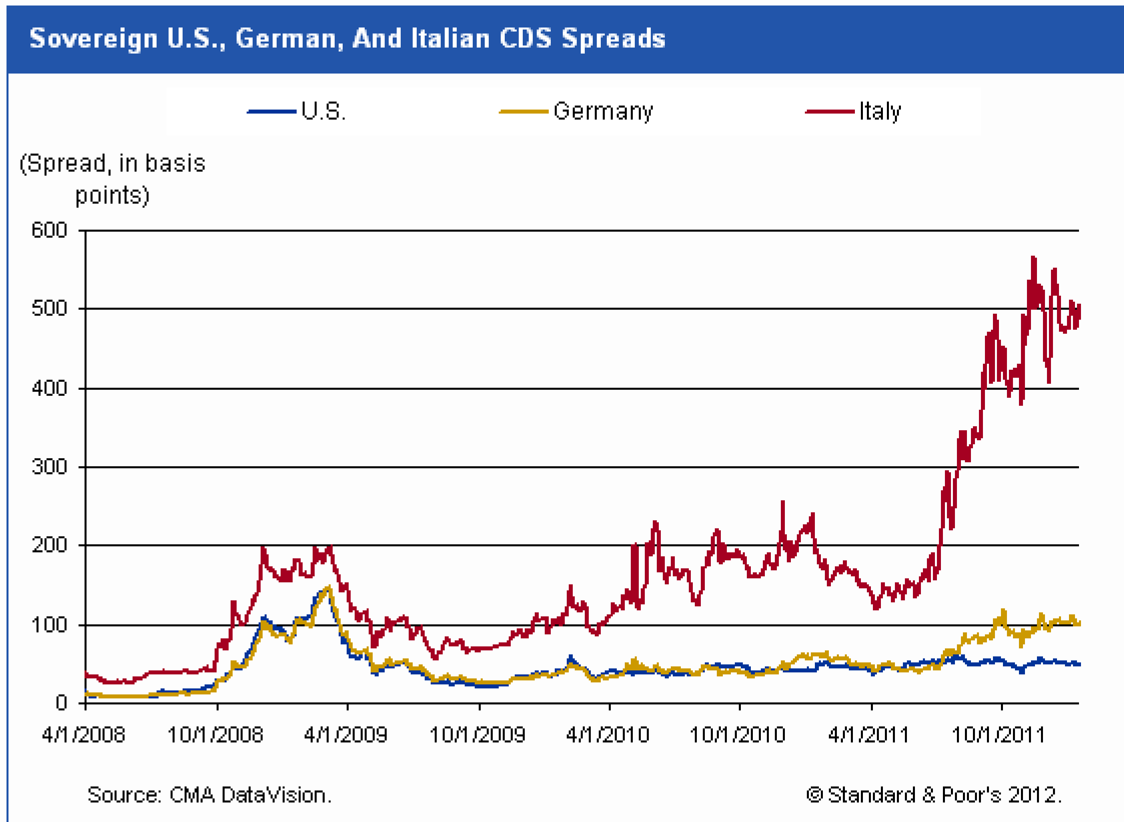
In the fourth year of post-recession recovery, barring any large external macroeconomic shocks, we believe it is reasonable to anticipate further improvement in employment and in the rate of home sales and home prices at this point in the business cycle. In an environment of sustained job creation and income growth, the rate of U.S. existing home sales should be able to approach and possibly surpass the historically modest five million annualized unit sales level by year-end 2012, presuming the U.S. economy can hold together this year.

Sovereign Credit

We will continue to monitor the global sovereign credit situation according to the insights provided by the credit default swap (CDS) market, as we believe contagion risk represents the largest threat to investors. Italian sovereign CDS spreads appear to have stabilized at approximately 475 basis points (bps) to 500 bps since Dec. 21, when the European Central Bank announced it had established a facility providing three-year 1% term loans to banks (see chart 3). The high end of the recent Italian CDS range is 550 bps to 575 bps, while the low end is 375 bps to 400 bps. Movement to either side of this range would signal how market participants perceive developed European sovereign credit risks to be evolving in the near term. Improving global economic prospects backstopped by coordinated pro-growth global central bank policies

would provide a foundation for the risk-on trade in 2012, while a lackluster and cyclically counterintuitive global economic response to these steps summarize the risks to the larger game plan and outlook, in our opinion.

Chart 3



Inside This Issue:

Macroeconomic Overview

GMI Research believes that improving global economic prospects backstopped by coordinated pro-growth global central bank policies provides a foundation for the risk-on trade in 2012. Likewise, a lackluster and cyclically counterintuitive global economic response to these steps summarizes the risks to the larger game plan and outlook. For now, the GMI team will continue to monitor the rate of U.S. job creation, the prospects for an upswing in the U.S. housing market, and the level of market concern regarding questions and risks associated with global sovereign credit quality.

Economic And Market Outlook: North American And European Earnings

As North American companies continue to report fourth-quarter earnings, miss rates and beat rates are running very close, with 34% of companies missing and 49% beating expectations. This represents the lowest beat/miss ratio seen in 10 years. Meanwhile, analysts expect European corporate earnings to remain strong in the next two years, with 2012 and 2013 growth forecasts of 9.6% and 9.5%, respectively.

S&P Index Commentary: The Power Of Dividends

Almost 13 years ago, the trailing operating price-to-earnings (P/E) ratio was 29.4, compared with the current 13.5, while

the index yielded 1.3%, compared with 2.1% now. Now, here we stand at a much lower P/E, a much higher dividend yield, record earnings, record cash flow, and record cash, but an index level that is basically flat.

Leveraged Commentary And Data: Leveraged Loan Repayment Rate Climbs To Five-Year High In 2011

In 2011, strong market conditions lifted the repayment rate of S&P/LSTA Index loans to a five-year high of 40%, versus 27% in 2010 and a historical average of 36.6%. After four calendar years, a record 40% of 2007 vintage loans remain outstanding. By comparison, of loans originated between 1997 and 2006, 15.8% were still outstanding after four years.

R2P Corporate Bond Monitor

Despite substantial headwinds in the fixed-income markets, risk-reward profiles--as measured by average Risk-to-Price (R2P) scores--improved overall since the beginning of the year, from Dec. 30, 2011 to Jan. 18, 2012, excluding the U.S. utilities and the European consumer staples sectors.

S&P Index Municipal Commentary: Municipal Bond Defaults Are Headed In The Right Direction

In 2011, 44 bond deals experienced their first event of monetary default by missing a payment on all or part of the principal and/or interest due on their bonds. The total par value of these bond deals, at $1.247 billion, compares favorably with 153 deals totaling $3.234 billion in 2009 and 110 deals amounting to $2.65 billion in 2010.

Market Derived Signal Commentary: Homebuilders' CDS Spreads Show Positive Trend

Homebuilders' five-year credit default swap (CDS) spreads tightened 8.4% for the week ended Jan. 17, 2012, extending a month-long trend. Although a real recovery in homebuilding has yet to gain traction, we think the trend in the CDS spreads for this group gives investors potential trade opportunities on a selective basis.

Capital Market Commentary: A 2011 Review Of Leaders And Laggards

Using S&P Capital IQ data, we determined the performance from offer date to year-end 2011 for IPOs priced on major U.S. exchanges. Of the top 10 leaders, six have given up ground in early 2012 trading. Among the 10 worst performers among U.S. IPOs priced last year, all but one have posted gains so far in 2012.

S&P Index Commodity Commentary: Industrial Metals Recover

Optimism has characterized the commodity market so far in 2012, illustrated by the sharp rally in the industrial metals sector, which was the worst performing sector in 2011. Most market participants hope the recovery in industrial metals prices is sustainable, indicating an increasingly optimistic global economic outlook.

Economic And Market Outlook: North American And European Earnings

North America

Fears regarding a weak earnings season continued to run high this week. Since Tuesday, 47 companies have reported results, with 28 beating, 15 missing, and four meeting expectations. While the number of companies surpassing estimates this week is nearly twice the amount of those falling short, disappointing results from some big banks have been a cause for concern. In all, 77 companies have reported their fourth-quarter figures, and of that amount, 42 beat, 26 missed, and 9 met expectations (see table 1). Miss rates and beat rates are running closer than usual at this point, with 34% of companies missing and 55% beating expectations, representing the lowest beat rate in 10 years. The long-term historical average beat rate is 62%, and the average over the last four quarters is 68%.

Table 1

Fourth-Quarter 2011 Earnings Statistics

		--Actuals vs. expected earnings--				--Actuals vs. expected earnings--			
	Actual vs. mean for 4Q2011 (%)	Total reported	Beat	Miss	Met	Total reported (%)	Beat (%)	Miss (%)	Met (%)
Consumer discretionary	0.05	11	4	5	2	14.10	36.36	45.45	18.18
Consumer staples	(0.18)	6	1	4	1	14.63	16.67	66.67	16.67
Energy	0.09	1	1	0	0	2.44	100.00	N.A.	N.A.
Financials	(0.83)	26	11	12	3	32.10	42.31	46.15	11.54
Health care	0.63	3	3	0	0	5.77	100.00	N.A.	N.A.
Industrials	0.90	8	6	1	1	13.33	75.00	12.50	12.50
Information technology	0.33	16	11	3	2	21.33	68.75	18.75	12.50
Materials	0.37	5	4	1	0	16.67	80.00	20.00	N.A.
Telecommunication services	0.00	0	0	0	0	0.00	N.A.	N.A.	N.A.
Utilities	0.16	1	1	0	0	3.03	100.00	N.A.	N.A.
S&P 500 Index	0.19	77	42	26	9	15.40	54.55	33.77	11.69

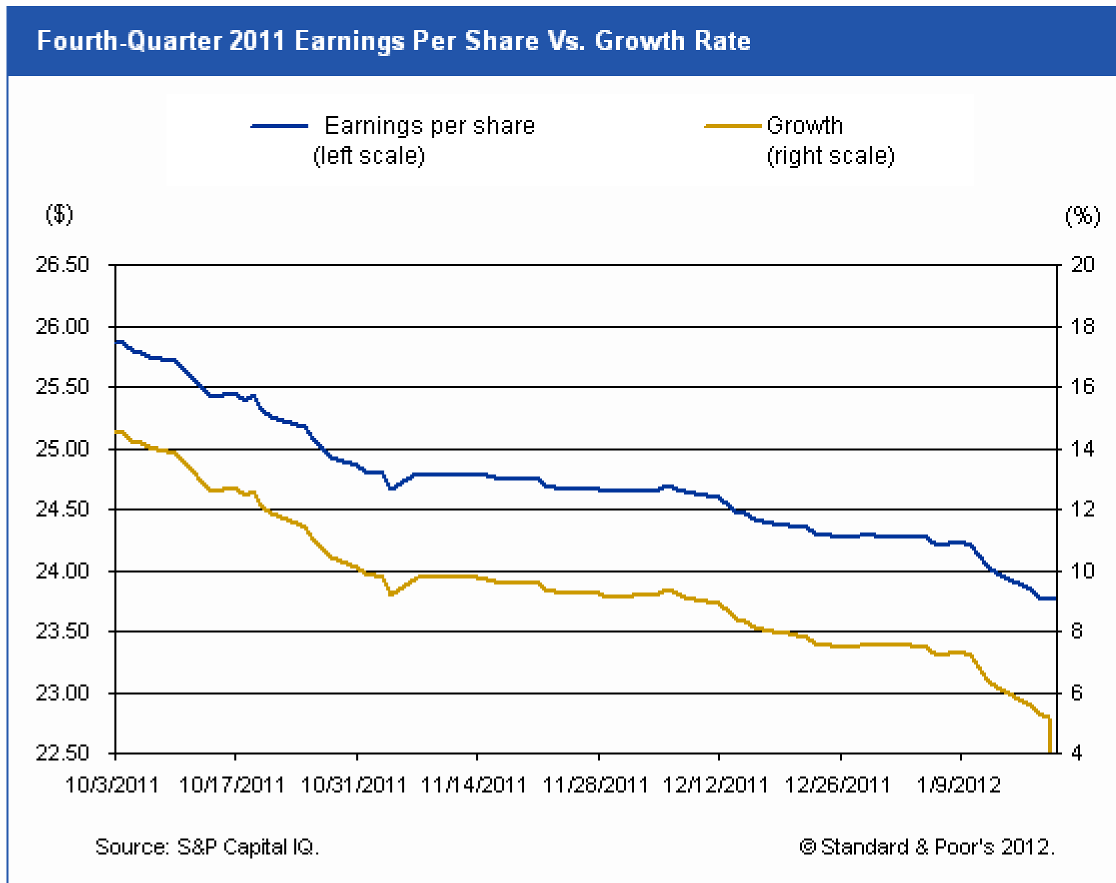
N.A.--Not available. Source: S&P Capital IQ.

Companies in nine of the 10 sectors have reported thus far, with telecommunications yet to report earnings. The financials sector has reported the most so far (26 companies), with 12 missing, 11 beating, and three matching estimates, for a low beat rate of 42%. While most financial firms have only missed expectations by a few pennies, others like Capital One Financial Corp., M&T Bank Corp., and Citigroup Inc., missed by $0.67, $0.48, and $0.21 per share, respectively. Eleven companies have reported within the consumer discretionary sector, with four beating, five missing, and two matching the consensus estimate, for a beat rate of 36%. Thus far, the information technology sector seems to be faring best, with companies surprising mostly to the upside. Of the 16 companies in that sector to report results, 69% topped expectations. And while only eight companies in the industrials sector have released results, six of those surpassed estimates, producing an impressive beat rate of 75% and helping the sector maintain its respectable growth rate of 8.0%, the second highest of all 10 sectors.

In fourth-quarter press releases, financials firms (Citigroup Inc., The Bank of New York Mellon Corp., JPMorgan Chase & Co., PNC Financial Services Group, among others) blamed low interest rates, slow economic growth, new regulations, and lower than usual client activity for weak results. Similarly, consumer discretionary companies (Best Buy Co. Inc., Darden Restaurants Inc., CarMax Inc., and others) cited the uncertain economic environment and the cautious consumer for their subpar results. December retail sales rose only 0.1% from November, which fell short of the consensus expectation of a 0.4% increase. Part of the reason for the miss was upward revisions to November and October figures. After hitting a peak of 1.1% growth in September, retail sales have continued their downward trend since October. Despite this, the small 0.1% increase in December was enough to push 2011 retail sales into record territory, reporting 8% growth over 2010, the highest since 1999.

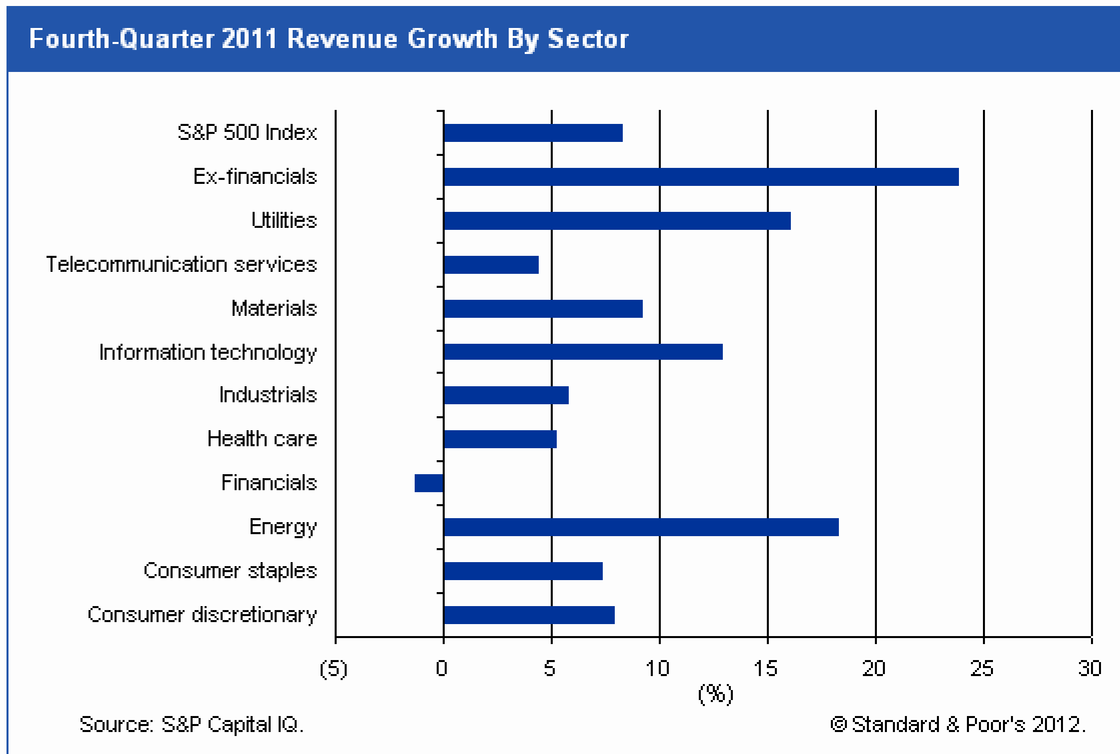
It's not too surprising that the S&P 500 Index blended growth rate continues to fall. Currently, the expected growth rate stands at 5.19%, little more than a third of the 14.55% expected at the beginning of the calendar quarter in October (see chart 4). Since last week alone, this number has dropped by more than a percentage point. The yearly number, which companies are also reporting this earnings season, is faring better, with an expected growth rate of 15.2%. That figure has changed less than 1.5% since October. For the fourth quarter, analysts expect seven of the 10 sectors to report growth and for the energy sector to report double-digit earnings growth of 14.37%.

Chart 4



On a more positive note, revenues are outpacing earnings, which is unusual as the former has lagged the latter since the second quarter of 2009. Currently, the revenue growth rate stands at a very strong 8.4% due to strength from the energy and utilities sectors (see chart 5). Earnings growth of just 5.19% is causing quite a bit of margin compression. The current blended dollar amount for revenues is $2.59 trillion, while earnings stand at $214.6 billion, producing a profit margin of 8.27%. This is lower than last quarter's reported profit margin of 9.17% (revenues of $2.53 trillion versus earnings of $231.8 billion). With raw material costs still high at the beginning of the fourth quarter, and energy costs that continue to rise, margins were squeezed as suppliers struggled to pass prices on to consumers. As we saw over the holiday season, for example, many retailers had to offer deep discounts in order to lighten inventory levels. However, weak earnings growth was largely expected, and analysts don't expect a collapse into negative territory. Stocks are still cheap, with 12-month forward (starting with first-quarter 2012) price-to-earnings (P/E) levels remaining low, at 12.4x earnings.

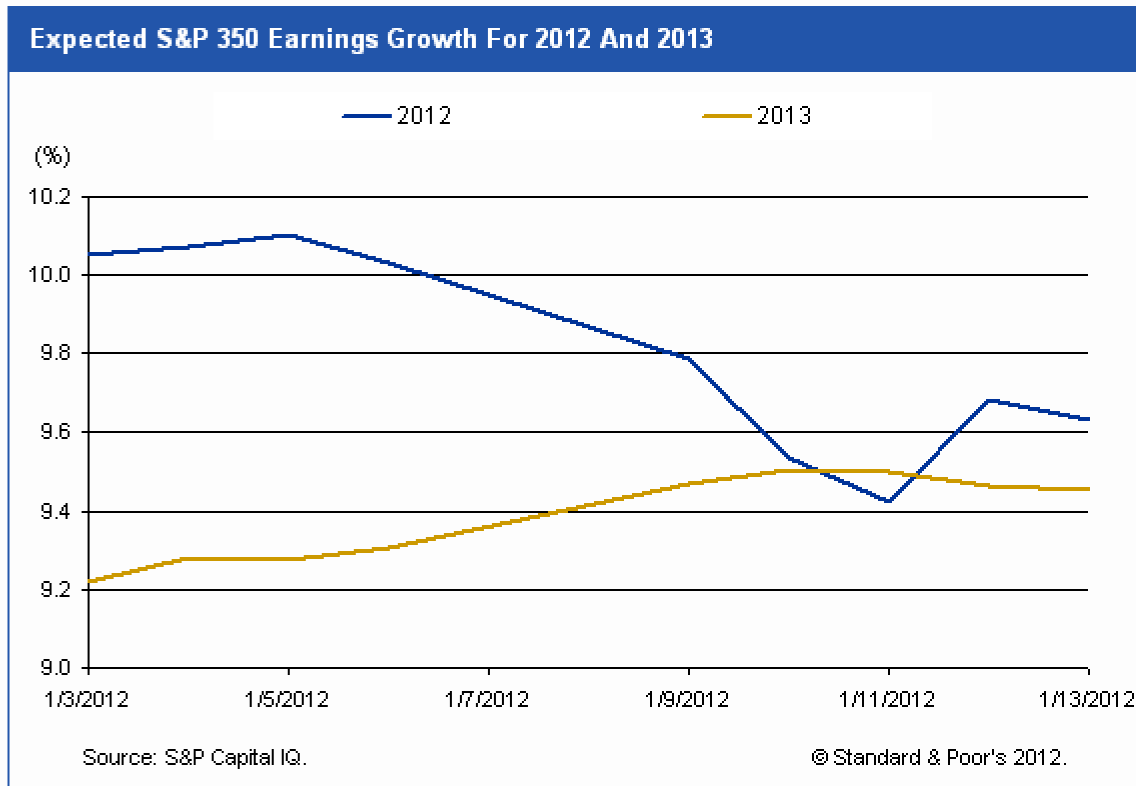
Chart 5



Europe

During the first three weeks of the year, analysts lowered their 2012 earnings expectations 1.1% and their 2013 estimates 0.9%. Nevertheless, analysts expect European corporate earnings to remain strong in the next two years, with 2012 and 2013 growth forecasts of 9.6% and 9.5%, respectively (see chart 6).

Chart 6



While the commodity-related sectors led earnings growth in 2011, a slump in expectations for the financials and utilities sectors led to overall estimated earnings growth of less than 1% for the S&P Europe 350 Index last year. This is a very low number, even considering the 43% growth in 2010 during the recovery from the 2008 credit crunch. In comparison, the S&P 500 Index ended the year with 16% earnings growth--the strongest since 2005, excluding the 40% growth rate in 2010 (inflated due to very easy comparisons to 2009).

Analysts have been very optimistic about earnings growth in 2012 for the two cyclical sectors--financials and industrials--with 24% and 14% growth expectations, respectively, despite the global sovereign debt crisis. At the same time, analysts expect the energy and materials sectors, which led earnings growth last year, to grow more moderately, by 7% and 4%, respectively. Analysts' 2013 growth estimates are much more even among all 10 sectors, with only one leader emerging--the information technology sector, most likely because of the expected decline in 2012 earnings growth for the sector.

In 2012, the information technology sector is the only sector expected to show a year-over-year decline in earnings, of nearly 3%. The health care sector is also expected to lag, with expected growth of 1%. In 2013, no prominent laggards have emerged thus far, with three sectors--telecoms, utilities, and energy--expected to report the most subdued growth (between 4% and 5%).

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 Power Of Dividends

Four thousand six hundred and ninety four days ago, the S&P 500 Index brought to the market a new record level, conceived in capitalism, and dedicated to the proposition that all investors are created equal. That level was 1,300, and that date was March 15, 1999--the Ides of March (see table 2).

Table 2

S&P 500 Sector Changes Since March 15, 1999

	--Return (%)--		--Annualized (%)--		--Market representation (%)--	
	Stock	**Total**	**Stock**	**Total**	**1/18/2012**	**3/15/1999**
S&P 500	0.06	26.20	0.00	1.83	12.09	5.49
Consumer discretionary	20.07	40.37	1.43	2.67	3.69	2.93
Consumer staples	38.57	88.38	2.57	5.05	10.95	9.92
Energy	181.88	266.07	8.40	10.63	10.82	12.87
Financials	(46.55)	(28.91)	(4.76)	(2.62)	11.00	9.80
Health care	5.31	30.25	0.40	2.08	11.76	12.62
Industrials	29.65	66.97	2.04	4.07	14.05	16.53
Information technology	(11.65)	(4.64)	(0.96)	(0.37)	19.19	18.51
Materials	76.03	135.37	4.50	6.89	2.83	8.69
Telecommunication services	(56.12)	(29.78)	(6.21)	(2.71)	3.60	2.64
Utilities	15.85	89.67	1.15	5.11	100.00	100.00
S&P 500 Index (price)					1,308.04	1,307.26

Source: S&P Indices.

Almost 13 years ago, the trailing operating P/E ratio was 29.4, compared with the current 13.5, while the index yielded 1.3%, compared with 2.1% now. Now, here we stand at a much lower P/E, a much higher dividend yield, record earnings, record cash flow, and record cash--but an index level that is basically flat.

Within the index, things have definitely changed. Unlike the roaring 90s, when the information technology sector was the winner, the energy sector is up 188% from March 15, 1999, and higher by 266% on a dividend-adjusted basis, for a 10.6% annualized return. The materials sector, which stumbled lately on rising commodity prices, returned 6.9% annually, including dividends. The utilities sector returned 5.1% with dividends, but only 1.2% without them.

On the downside, the telecommunications sector has lagged the most, falling 6.2% annually based on stock price, but the decline narrows to 2.7% after factoring in dividends. The financials sector also declined, losing 2.6% including dividends. The consumer staples sector was a sleeper, returning 2.6% based on stock, and 5.1% on a total return basis annually. Since March 15, 1999, consumer staples weathered the vagaries of the market better than other sectors--not only were earnings affected the least, few companies lowered their dividend.

In retrospect, the main difference between 13 years ago and today is what investors are willing to pay for a stock, which is reflected in the P/E ratio. If stocks were selling at the 1999 level, the index would have appreciated to 2,800, and the discussion would be focused on when it would hit 3,000. One reason is an uncertain outlook. Analysts polled by S&P Capital IQ are forecasting another strong year for earnings in 2012, but investors aren't banking on those estimates, given the many exogenous factors at play. To wit, future tax rates for individuals and corporations are yet unknown, it's unclear what the Social Security tax will be in March, and repatriation has returned to the discussion amid rumors of another depreciation schedule.

In addition, the Supreme Court will make a decision on Obama's health care plan in June. Although the housing market is showing signs of recovery, inventories remain high amid slow job growth. Meanwhile, debt problems continue to plague Europe. Since investors have no clear view for this year, much less next year, they have no reason to pay a higher premium on earnings.

Broad index investing balances out the risk and rewards; The S&P 500 Index broke even or returned 26% including dividends over the past 13 years. Investors interested in specific sector plays may also want to consider sector ETFs for a more concentrated investment. Although sector investing provides investors with a lower return compared with individual shares, the risk is also lower, and we see this type of investing appealing to a broadening group of market players.

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

Leveraged Commentary And Data: Leveraged Loan Repayment Rate Climbs To Five-Year High In 2011

In 2011, strong market conditions lifted the repayment rate of S&P/LSTA Index loans to a five-year high of 40%, versus 27% in 2010 and a historical average of 36.6% (see chart 7).

Chart 7

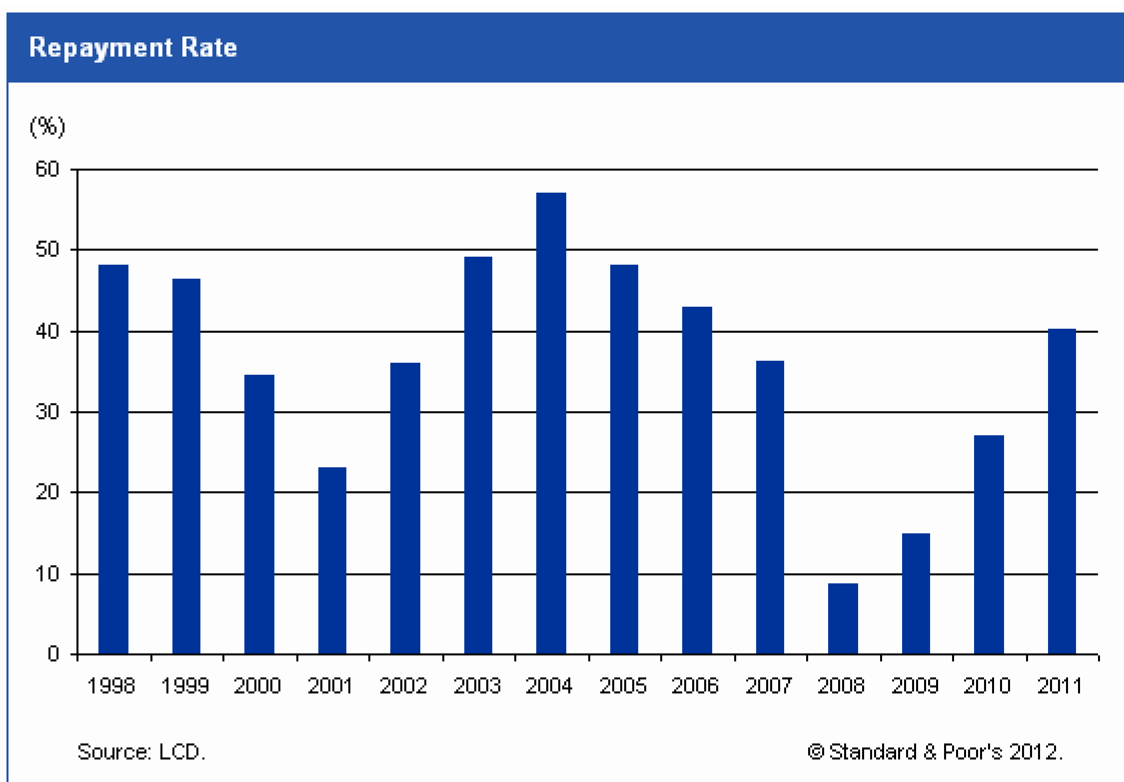
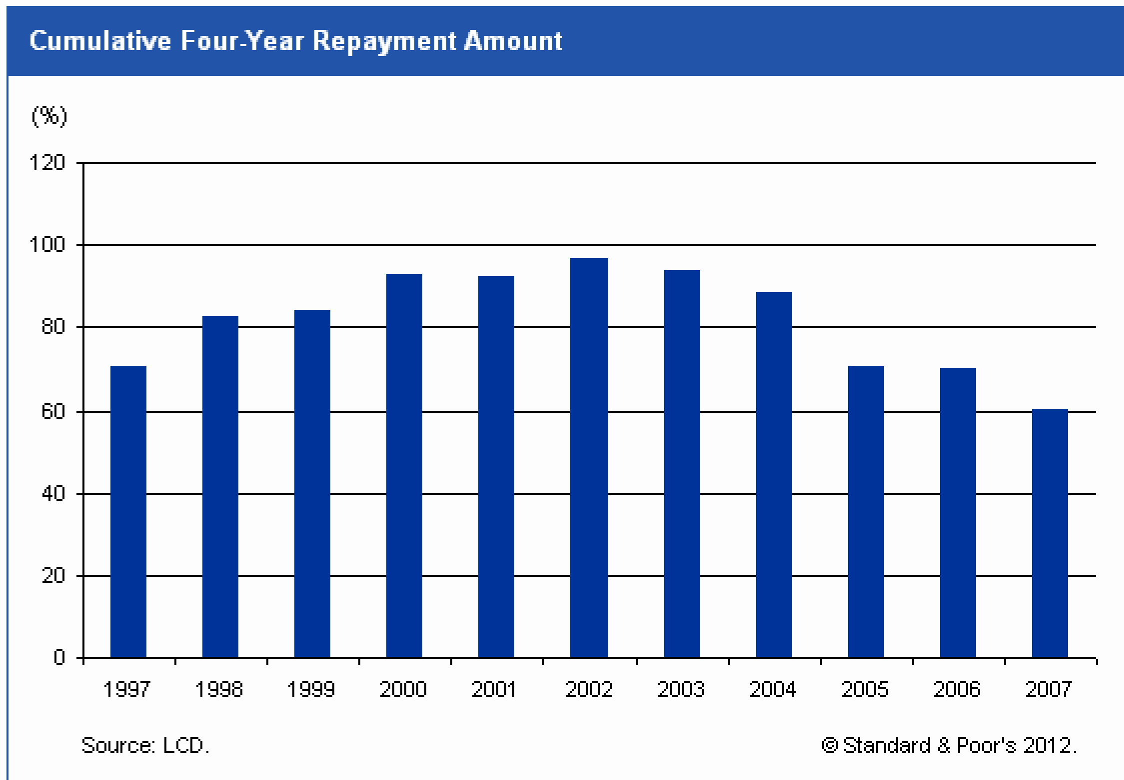


Chart 8 shows that it was a steep climb for repayment rates from the unprecedented lows of the credit crunch. As a result, the 2007 class of institutional loans--and to a lesser extent the 2006 class--has been slow to leave the field. After four calendar years, a record 40% of 2007 vintage loans remain outstanding. By comparison, of loans originated between 1997 and 2006, 15.8% were still outstanding after four years.

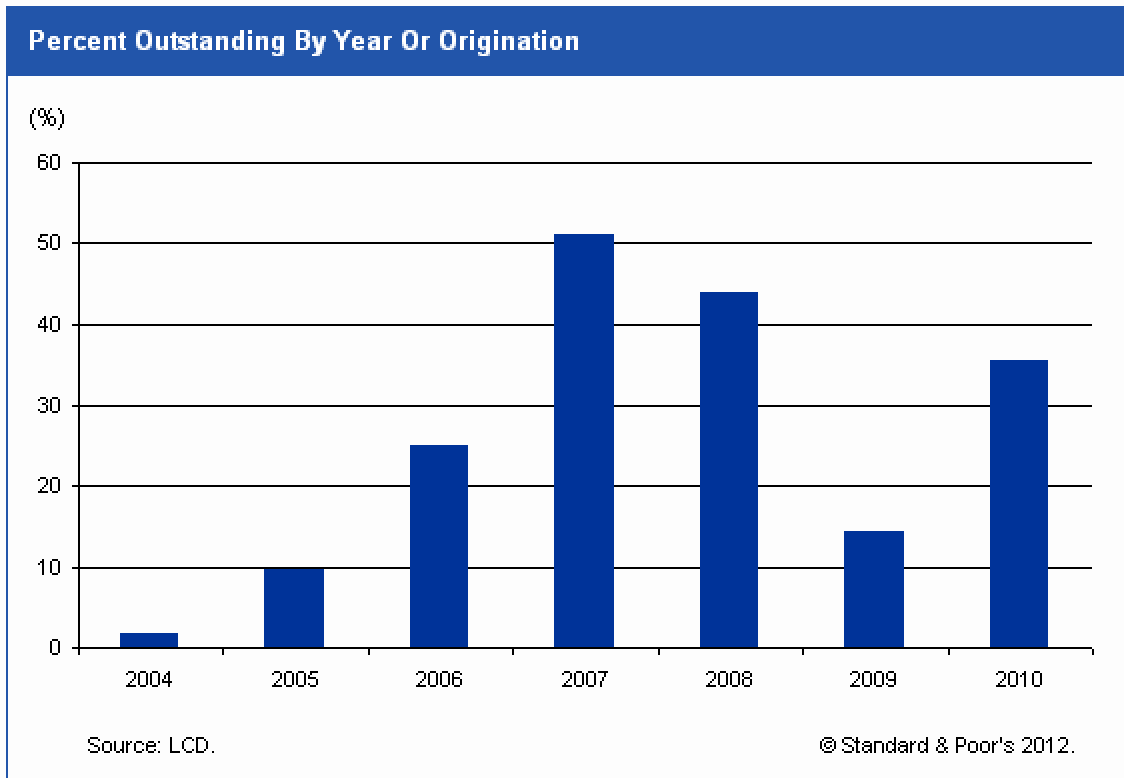
Chart 8



These numbers understate the longevity of the 2006 and 2007 loans because extended paper is excluded from the mix. If amend-to-extend loans are included--for example, TXU's $15.4 billion extended loan is dated to 2007, rather than its 2010 extension date--the percent of 2007 loans still outstanding at year-end jumps to 51.2%. The effect is similar for 2006 loans, with 25.2% outstanding at year-end 2011, compared with a historical average five-year rate of just 7.4% (see chart 9).

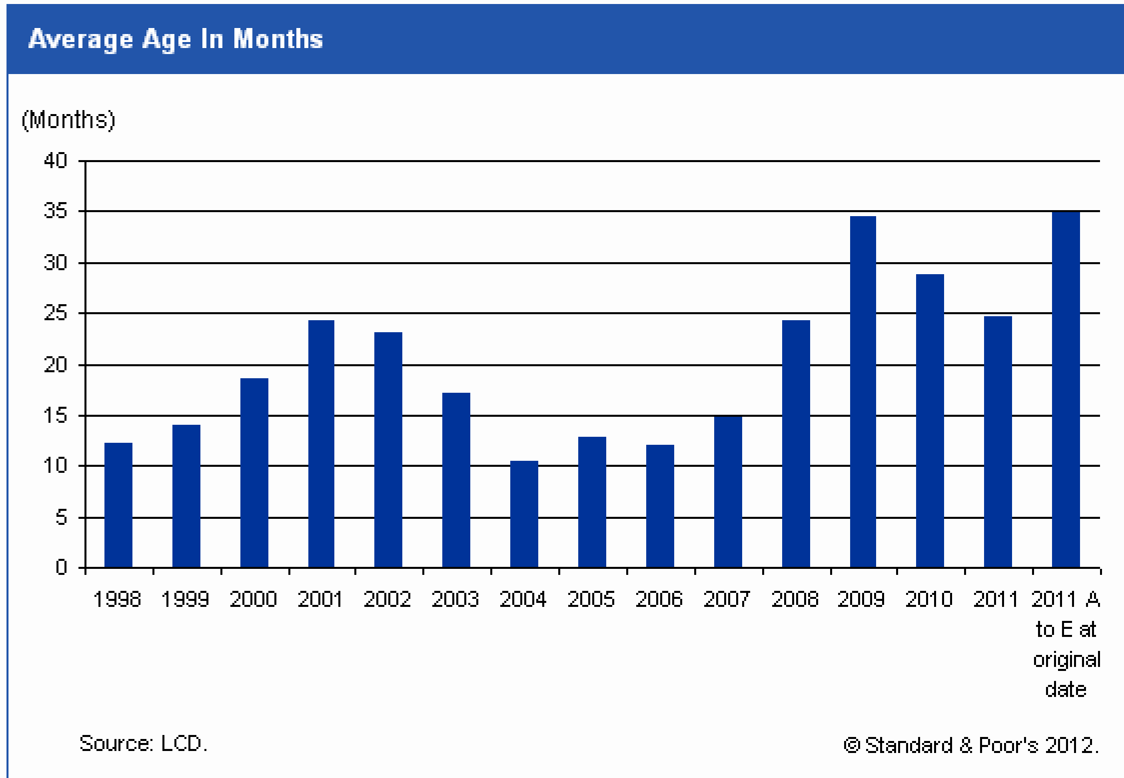
The institutional universe is different from that of past years in that a greater percentage of 2007 loans are now outstanding than those of subsequent loan classes--a rare phenomenon over the 14-year history of the S&P/LSTA Index.

Chart 9



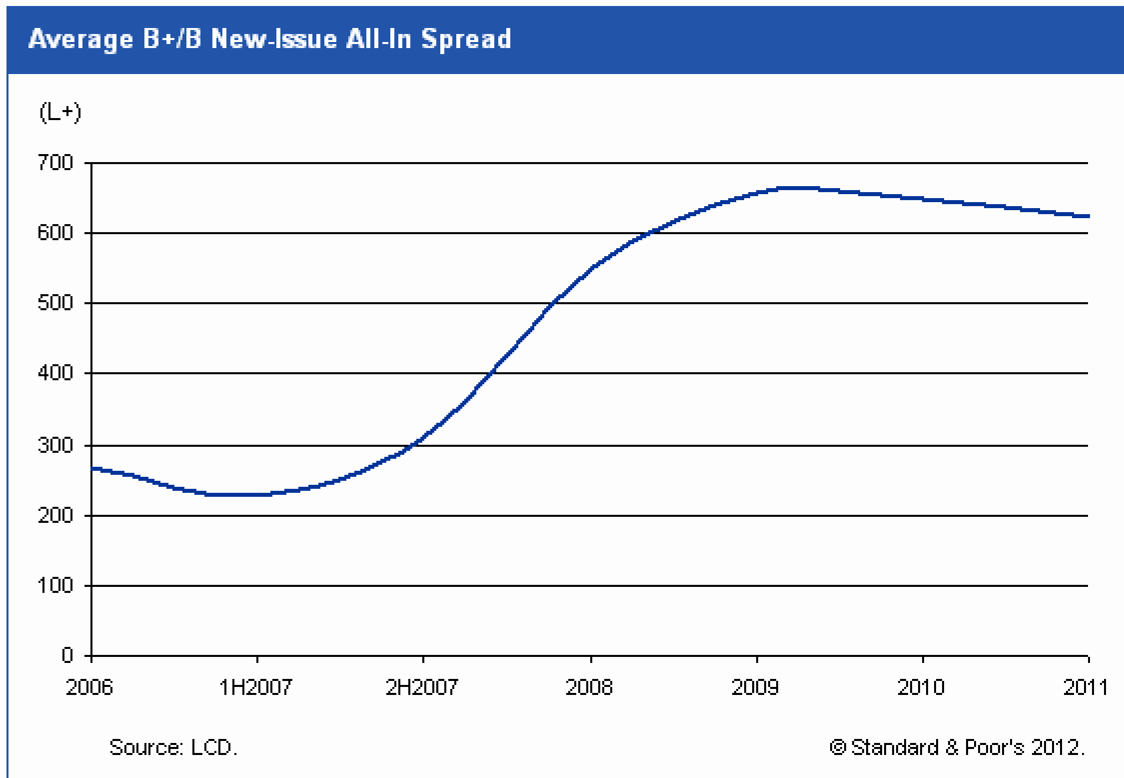
The graying of 2006 and 2007 loans pushed the average age of index loans to a near-record 34.8 months in 2011. Again, that figure counts extended loans from their original dates. Using the extension date instead, the average age of S&P/LSTA Index loans falls to 24.6 months (see chart 10).

Chart 10



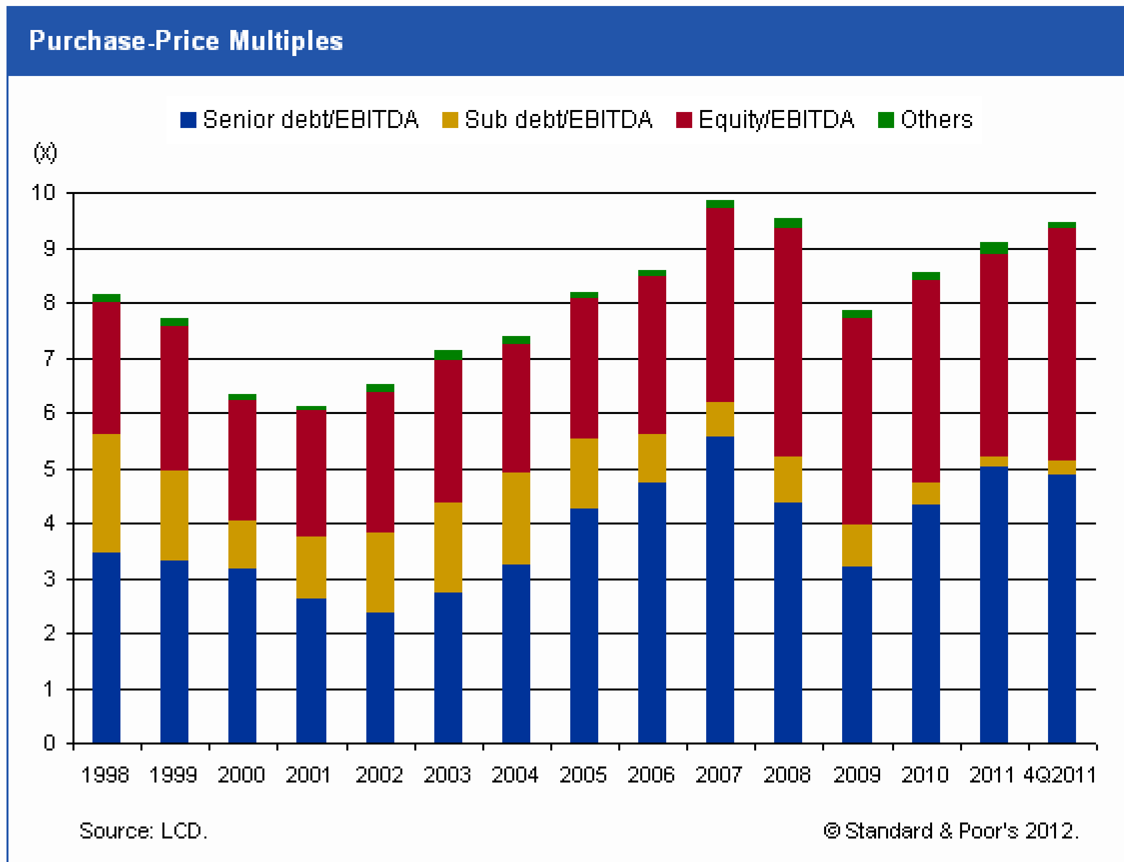
Not for nothing have 2006 and 2007 loans lingered. For one thing, the tight spreads at which issuers were able to print loans during that liquidity-soaked era have yet to return, discouraging refinancing (see chart 11).

Chart 11



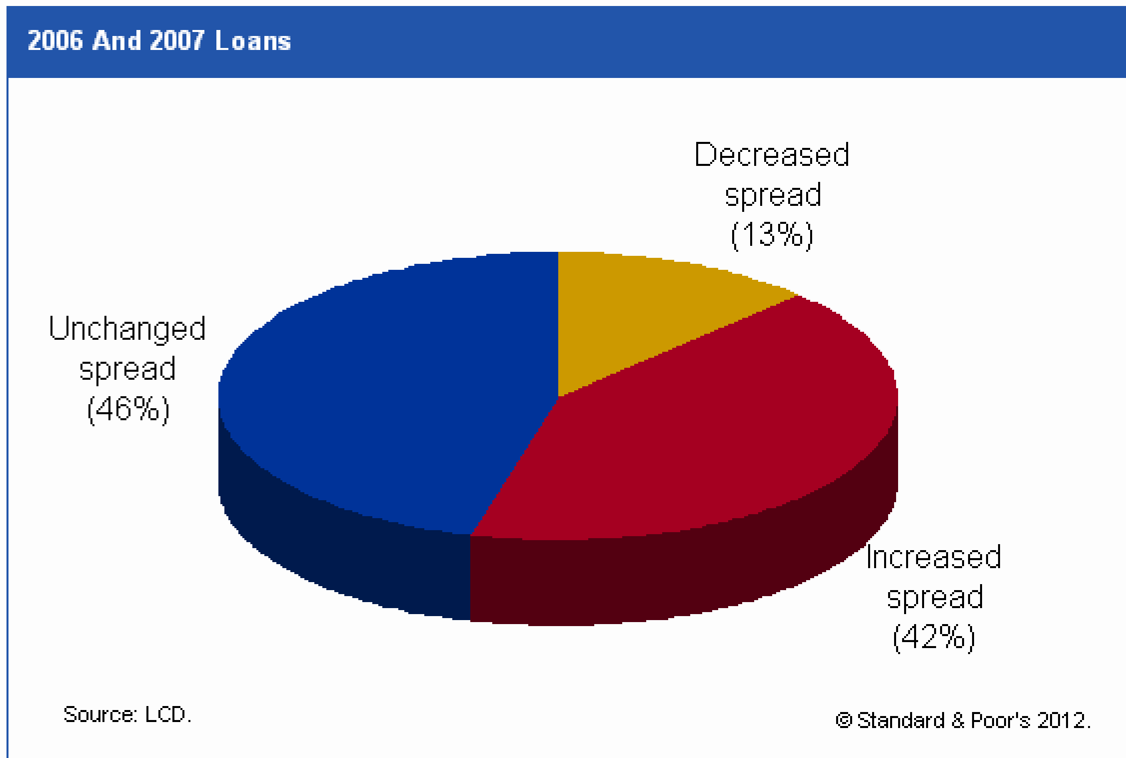
For another, the massive purchase-price multiples and leverage levels of LBOs structured in 2006 and 2007 also have made it difficult for these issuers to exit directly, either via a straight refinancing, an IPO, or an M&A trade (see chart 12).

Chart 12



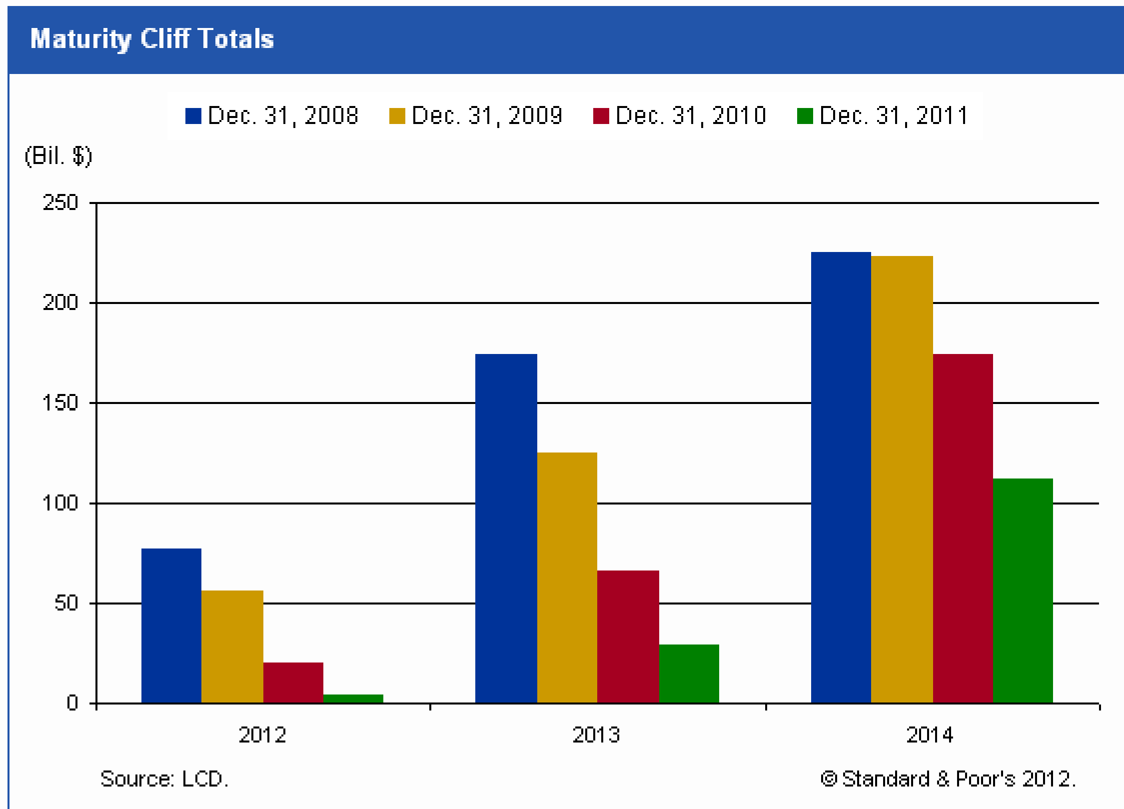
Although 2006 and 2007 loans have abided longer than prior vintages, lenders have boosted the spread of 42% of the loans still outstanding by an average of 41 bps, either via amend-to-extends or covenant relief (see chart 13).

Chart 13



Moreover, the extension trade has allowed issuers of 2006 and 2007 loans to lengthen maturities, easing the maturity wall significantly from its 2008 highs (see chart 14).

Chart 14



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

R2P Corporate Bond Monitor

While prospects for the U.S. economy are brightening, there remain significant problems that will still require considerable central bank support, according to Federal Reserve Bank of Chicago President Charles Evans. Europe's government-debt crisis and instability in the Middle East remain unpredictable threats to the U.S. economy. In Europe, German leader Angel Merkel admitted it could take months to rebuild confidence in the European Union.

Despite substantial headwinds in the fixed-income markets, risk-reward profiles--as measured by average Risk-to-Price (R2P) scores--improved overall since the beginning of the year, from Dec. 30, 2011 to Jan. 18, 2012, excluding the U.S. utilities and the European consumer staples sectors (see tables 3 and 4).

In the U.S., option-adjusted spreads (OAS) tightened by 3 bps on average. However, scores improved by 12% due to a decrease in the average probability of default (PD) and average bond price volatility of 13% and 10%, respectively.

In Europe, OAS tightened by 2 bps on average. However, scores improved by 9% due to a decrease in PD and in bond price volatility of 2% and 6%, respectively.

Table 3

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

	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	13	(11)	(26)	(1)

Table 3

North American Risk-Reward Profiles By Sector--Average R2P Score And Components Changes (cont.)				
Consumer staples	6	(1)	17	(17)
Energy	14	(2)	(4)	(11)
Financials	4	(13)	(29)	(9)
Health care	8	(2)	(14)	(8)
Industrials	17	0	(4)	(11)
Information technology	19	13	(22)	(1)
Materials	35	(11)	(34)	(20)
Telecommunication services	9	0	(17)	(7)
Utilities	(2)	0	8	(12)

Change as of Jan. 18, 2012, from Dec. 30, 2011. OAS--Option-adjusted spread. PD--Probability of default.

Table 4

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

	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	3	2	11	2
Consumer staples	(7)	(1)	8	2
Energy	12	12	(20)	(15)
Financials	14	(9)	(7)	(14)
Health care	16	31	62	11
Industrials	14	(10)	(11)	(6)
Information technology	7	(17)	(36)	(9)
Materials	11	(9)	(15)	(6)
Telecommunication services	6	(14)	(23)	(6)
Utilities	16	(5)	10	(18)

Change as of Jan. 18, 2012, from Dec. 30, 2011. OAS--Option-adjusted spread. PD--Probability of default.

Contact Information: Fabrice Jaudi, Senior Director—Global Markets Intelligence, Fabrice_Jaudi@standardandpoors.com

S&P Index Municipal Commentary: Municipal Bond Defaults Are Headed In The Right Direction

In 2011, 44 bond deals experienced their first event of monetary default by missing a payment on all or part of the principal and/or interest due on their bonds. The total par value of these bond deals, at $1.247 billion, compares favorably with 153 deals totaling $3.234 billion in 2009 and 110 deals amounting to $2.65 billion in 2010.

On Dec. 30, 2011, the S&P Municipal Bond Index, which follows more than $1.3 trillion in municipal bonds, recorded 190 outstanding municipal bond deals in monetary default, representing just over 0.5% of the index's par value. Bonds in default remain in the index. Bond deals often have multiple bond issues with various coupons and maturities. The 190 bond deals in default include 289 different bond issues in the index, as indicated by unique CUSIP numbers (see table 5).

Table 5

S&P Municipal Bond Index--Outstanding Defaults (Par Value)

	No. of bond deals	Par value ($)	Percentage (%)
Multi family	14	116,545,000	1.76
Health care	21	615,537,489	9.28
Landbacked	83	1,541,789,000	23.25
Conduit	35	2,722,721,065	41.05

Table 5

S&P Municipal Bond Index--Outstanding Defaults (Par Value) (cont.)			
Other	37	1,635,644,929	24.66
Total defaulted bond deals	190	6,632,237,483	100
Default total		6,632,237,483	
Overall total		1,322,626,534,661	

Data as of Dec. 30, 2011. Sources: S&P Indices and S&P Global Data Solutions.

Contact Information: J.R. Rieger, Vice President—S&P Indices, James_Rieger@standardandpoors.com

Market Derived Signal Commentary: Homebuilders' CDS Spreads Show Positive Trend

Homebuilders' five-year credit default swap (CDS) spreads tightened 8.4% for the week ended Jan. 17, 2012, extending a month-long trend that found support from Lennar Corp.'s positive quarterly results. From Jan. 10, the day before Lennar announced results, to Jan. 17, the average spread contracted to 599 bps from 654 bps, according to CMA DataVision. Over the past month, spreads tightened 15%. Similarly, the average spread for the S&P CDS U.S. Homebuilders Select 10 Index tightened 12.5% to 336 bps.

Although Lennar reported a decline in earnings per share on higher expenses, revenue grew by 11% year over year to $952.7 million on a 10% increase in home deliveries and an increase in the average sales price of delivered homes to $243,000 from $238,000 in the comparable period a year ago. These two metrics are considered positive signals for future home deliveries and revenues. Given that homebuilders are seen as a bellwether for the U.S. economy, the GMI research team believes the news supports our forecast for an ongoing slow but sustained recovery in U.S. GDP.

"We have seen the market start to stabilize, driven by a combination of low home prices and low interest rates, making the decision to purchase a new home more attractive, compared to the heated rental market," Lennar said. "These factors are reflected in our new orders and sales backlog, which increased 20% and 35%, respectively, from the prior year quarter."

Analysts polled by S&P Capital IQ expect homebuilders to earn $1.50 per share for 2011 and $9.77 for 2012, after losses of $203.55 in 2008, $57.90 in 2009, and $26.10 in 2011.

Within the homebuilding group, the tightest spreads belonged to Toll Brothers Inc. (169 bps), NVR Inc. (201 bps), and D.R. Horton Inc. (222 bps) (see chart 15). Hovnanian Enterprises Inc. (2,603 bps), Beazer Homes USA Inc. (1,030 bps), and KB Home (704 bps) had the widest spreads (see chart 16).

Chart 15

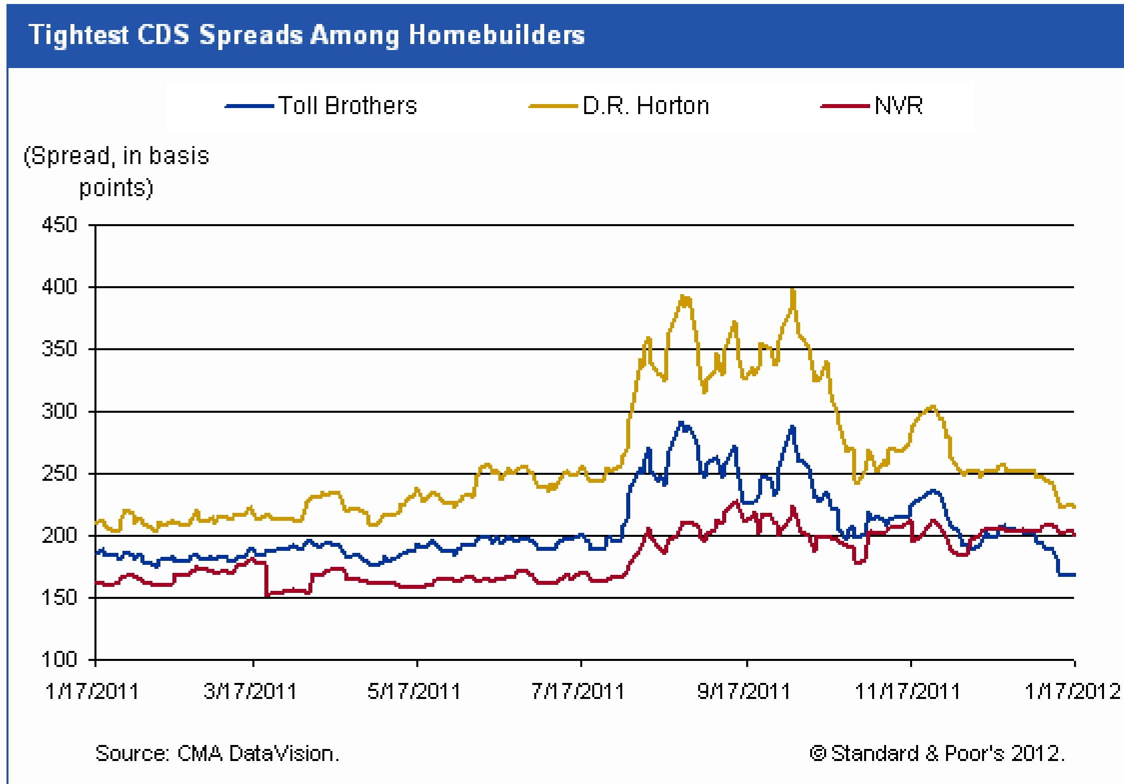
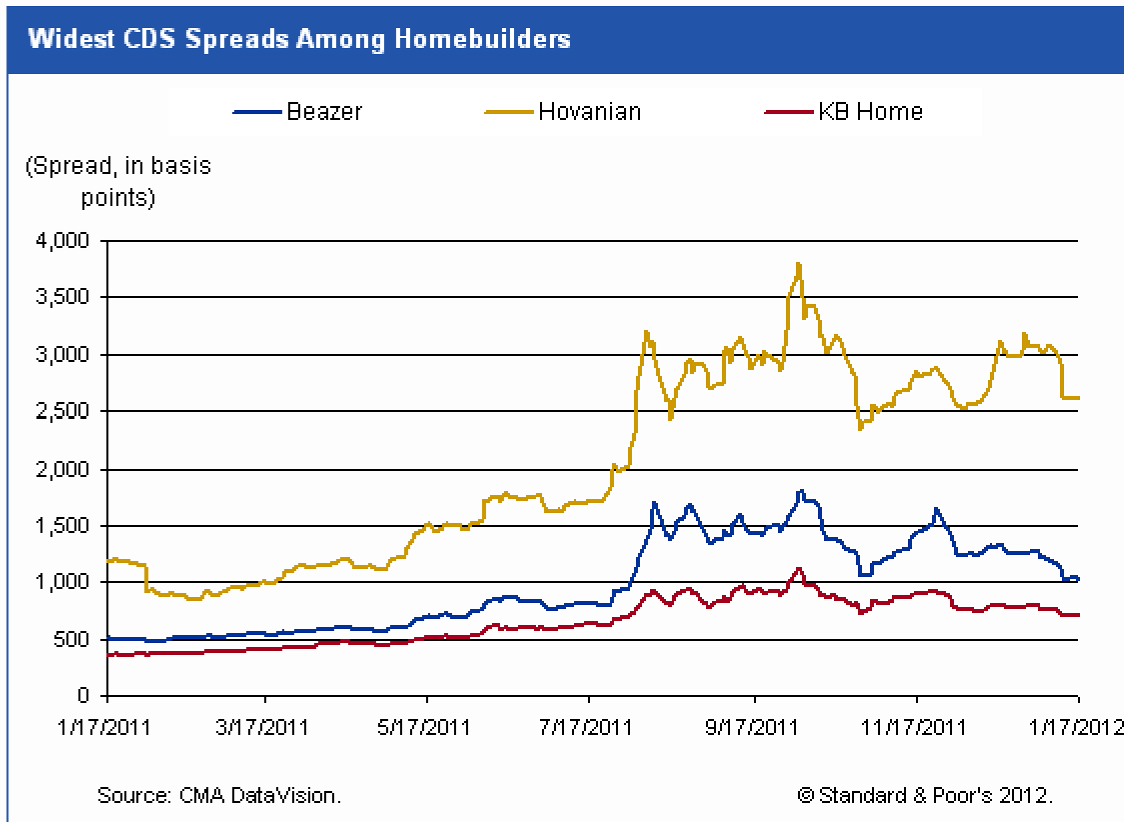


Chart 15



Although a real recovery in homebuilding has yet to gain traction, we think the trend in the CDS spreads for this group gives investors potential trade opportunities on a selective basis.

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

Capital Market Commentary: A 2011 Review Of Leaders And Laggards

IPOs

With the first U.S. IPO of 2012 completed (Iowa-based biodiesel company Renewable Energy Group raised $72 million in a 7.2 million common share offering), we reviewed how leaders and laggards of 2011 have fared in terms of equity performance. Using S&P Capital IQ data, we determined the performance from offer date to year-end 2011 for IPOs priced on major U.S. exchanges. Of the top 10 leaders, six have given up ground in early 2012 trading (see table 6). Among the 10 worst performers among U.S. IPOs priced last year, all but one have posted gains so far in 2012 (see table 7).

Table 6

Year-To-Date 2012 Performance Of 2011 IPO Leaders

	Target/Issuer	Total transaction value (mil. $)	Price per share ($)	Day close price Dec. 30, 2011 ($)	Change from offer to year-end (%)	Day close price ($)	Year-to-date 2012 change (%)
11/8/2011	Imperva Inc.	90.0	18	34.81	93.4	30.13	(13.4)
3/31/2011	GNC Holdings Inc.	360.0	16	28.95	80.9	27.93	(3.5)
4/19/2011	Tesoro Logistics LP	273.0	21	32.90	56.7	32.30	(1.8)
4/6/2011	CVR Partners LP	307.2	16	24.82	55.1	27.00	8.8
7/26/2011	Tangoe Inc.	87.7	10	15.40	54.0	14.71	(4.5)
4/5/2011	SandRidge Mississippian Trust I	315.0	21	31.05	47.9	32.47	4.6
5/4/2011	Thermon Group Holdings Inc.	120.0	12	17.62	46.8	16.75	(4.9)
6/16/2011	Bankrate Inc.	300.0	15	21.50	43.3	23.22	8.0
3/16/2011	Cornerstone OnDemand Inc.	136.5	13	18.24	40.3	18.17	(0.4)
5/17/2011	LinkedIn Corp.	352.8	45	63.01	40.0	70.33	11.6

Source: S&P Capital IQ.

Table 7

Year-To-Date 2012 Performance Of 2011 IPO Laggards

	Target/Issuer	Total transaction value (mil. $)	Price per share ($)	Day close price Dec. 30, 2011 ($)	Change from offer to year-end (%)	Day close price ($)	Year-to-date 2012 change (%)
5/10/2011	FriendFinder Networks Inc.	50.00	10.00	0.75	(92.5)	0.82	9.3
2/10/2011	Kips Bay Medical Inc.	16.50	8.00	1.34	(83.3)	1.72	28.4
2/7/2011	Imperial Holdings Inc.	179.17	10.75	1.88	(82.5)	1.94	3.2
5/4/2011	Renren Inc.	743.40	14.00	3.55	(74.6)	4.12	16.1
4/14/2011	Sequans Communications S.A.	77.00	10.00	2.78	(72.2)	2.51	(9.7)
8/16/2011	Tudou Holdings Ltd.	174.00	29.00	10.98	(62.1)	11.88	8.2
1/27/2011	BCD Semiconductor Manufacturing Ltd.	63.00	10.50	3.98	(62.1)	4.28	7.5

Table 7

Year-To-Date 2012 Performance Of 2011 IPO Laggards (cont.)

2/2/2011	Trunkbow International Holdings Ltd.	20.00	5.00	1.91	(61.8)	2.26	18.3
2/10/2011	AcelRx Pharmaceuticals Inc.	40.00	5.00	1.92	(61.6)	2.92	52.1
1/25/2011	Demand Media Inc.	151.30	17.00	6.65	(60.9)	6.99	5.1

Source: S&P Capital IQ.

M&A

Recent trends in quarterly domestic M&A deals may help to forecast the direction of fourth-quarter earnings performance for the S&P 500 financials sector. Fourth-quarter U.S. M&A volume dropped by more than 20% from the preceding quarter, according to S&P Capital IQ (see table 8). While M&A advisory fees vary from firm to sector to deal size, it's reasonable to infer that M&A fee income for the financial industry could decline, given the recent decline in M&A advisory assignments. To that end, the recent direction of sector earnings should be of little surprise.

Table 8

U.S. M&A And S&P 500 Financials Sector Earnings Per Share

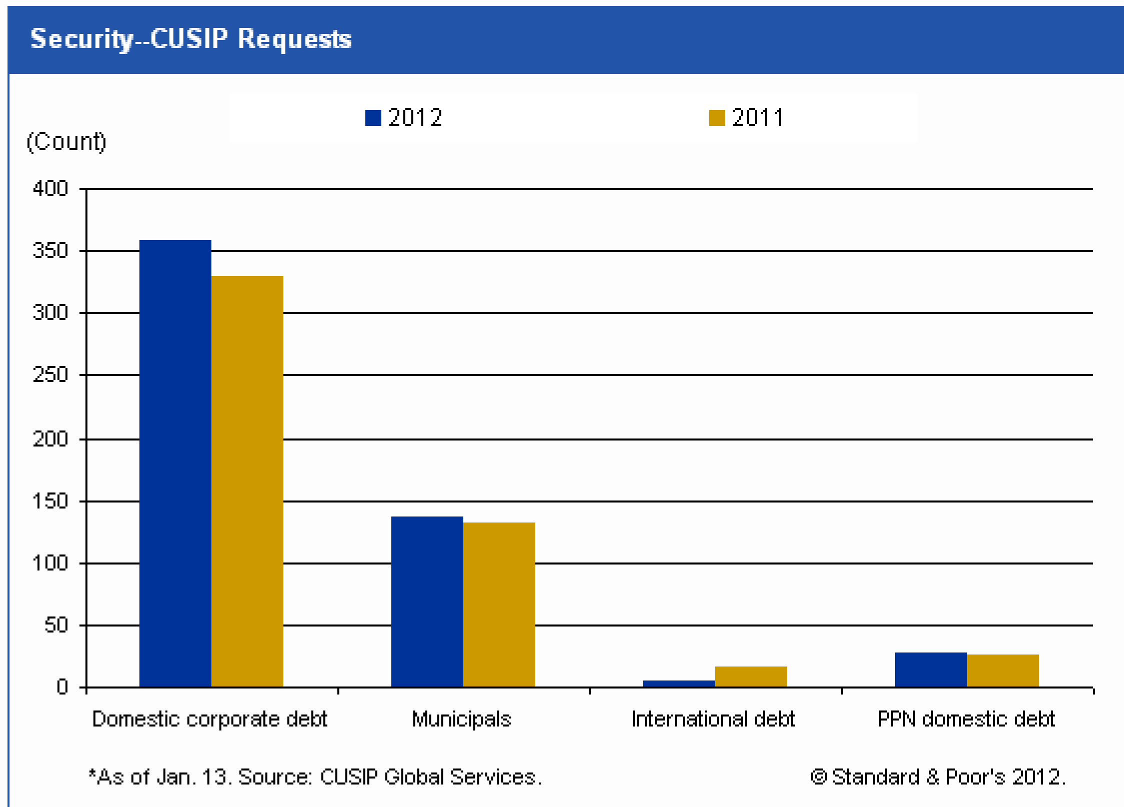
	U.S. M&A (bil. $)	Sequential quarterly change (%)	S&P 500 financials sector earnings per share ($)	Sequential quarterly change (%)
1Q2010	167.1	(29.3)	3.68	N.A.
2Q2010	206.7	23.7	3.71	0.80
3Q2010	201.6	(2.5)	3.75	1.10
4Q2010	222.8	10.5	3.46	(7.70)
1Q2011	252.4	13.3	4.09	18.20
2Q2011	270.3	7.1	4.20	2.70
3Q2011	257.8	(4.6)	3.93	(6.40)
4Q2011	205.3	(20.4)	3.56E	(9.40)

N.A.--Not available. Source: S&P Capital IQ.

Debt

Coming out of the gate, early security identifier requests for various debt instruments suggest a slightly higher number of offerings, which should be a positive signal for the capital markets sector. CUSIP orders for domestic corporate debt so far in 2012 are up 8.8% from this time a year ago, according to CUSIP Global Services data. Likewise, CUSIP requests for municipal securities have edged higher in early 2012 from the year-ago period. On the other hand, international debt securities identifier demand totals just five orders so far in 2012, compared with 16 in the comparable 2011 period. Finally, private placement note identifier requests have edged higher in early 2012 (see chart 16).

Chart 16



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

S&P Index Commodity Commentary: Industrial Metals Recover

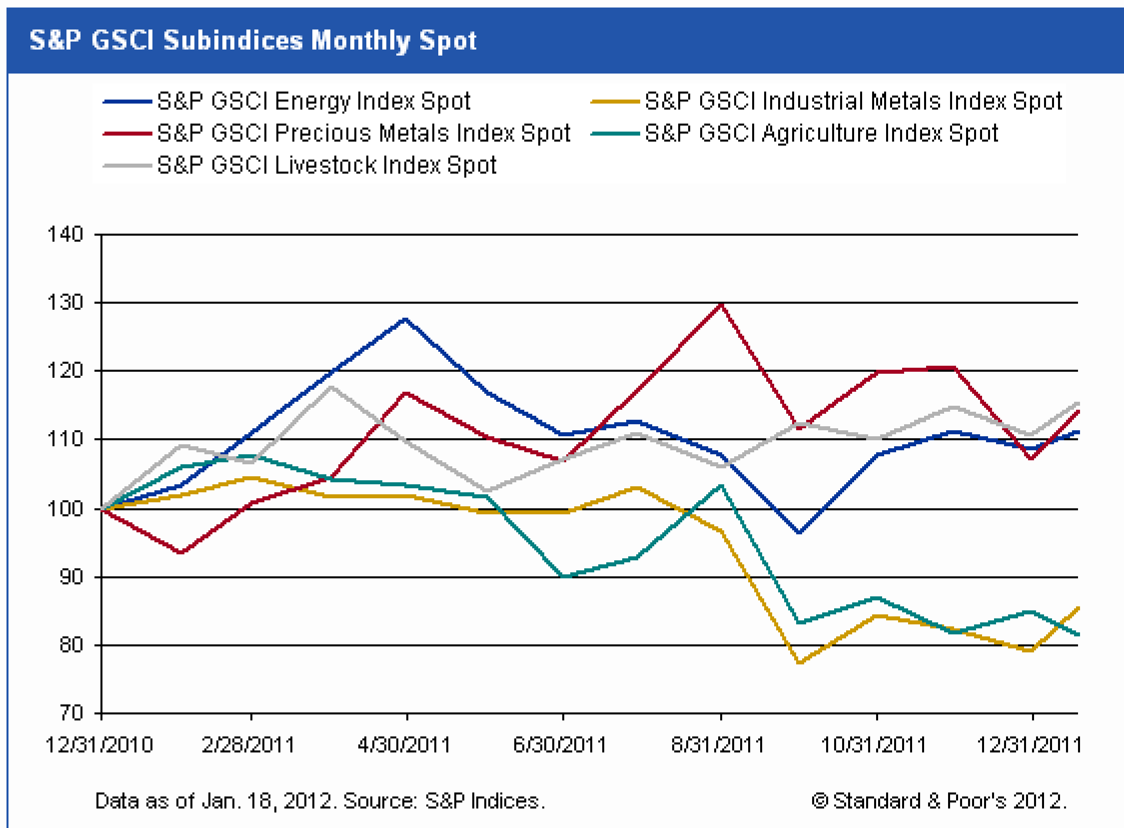
Coinciding with the recovery in global equity prices, the S&P GSCI Industrial Metals Index has led all sectors in 2012, with an increase of 7.94% as of Jan. 18. Year to date, the S&P GSCI Index has increased 1.71% after a 1.18% decline in 2011. In 2011, the industrial metals sector was the worst performing sector, as measured by a 22.33% decline in the S&P GSCI Industrial Metals Index. As of Jan. 18, the S&P GSCI Aluminum Index was the second best performing S&P GSCI single commodity index in 2012, with a gain of 8.84%, bested only by the 9.42% increase in the S&P GSCI Silver Index.

Sustained strength in industrial metals in 2012 after the downward trend in 2011 could imply a positive outlook for the overall economy. Most other S&P GSCI sectors have maintained 2011 trends so far in 2012, as measured by the increase of 2.17% in the S&P GSCI Energy Index, compared with the 0.60% increase in the S&P GSCI Non-Energy Index. In 2011, the S&P GSCI Energy Index gained 4.86%, compared with a decline of 13.27% in the S&P GSCI Non-Energy Index.

Agriculture prices have been the biggest sector drag in 2012, as measured by the 4.19% decline in the S&P GSCI Agriculture Index as of Jan. 18. Wheat was the worst performing agriculture commodity in 2011 and has continued to decline in 2012, as measured by the year-to-date decline of 9.27% in the S&P GSCI Wheat Index. Despite lackluster U.S. grain yields in 2011, global production improved sufficiently to provide a healthy boost to the stocks of most agriculture products. Chart 17 depicts the spot price changes of the main S&P GSCI sectors since the end of 2010. While prices of energy, livestock, and precious metals have similarly increased, prices of industrial metals and agriculture products have

similarly declined, leading some analysts to opine that the industrial metals and agriculture sectors may have the most potential to gain in 2012.

Chart 17



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

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