

Once Again, We Are Cautiously Optimistic At The Start Of The New Year

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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 financial markets, calendar-year 2011 was filled with "sound and fury," but in the end, perhaps "signifying nothing." This reference to Shakespeare's Macbeth summarizes our reaction to the fact that the S&P 500 Index ended the year unchanged (to the first decimal place) at 1257.60, compared with the 2010 closing mark of 1257.64. In a year characterized by multiple economic and geopolitical crosscurrents and excessive inter-day volatility in global financial markets, it is surreal--but perhaps fitting--that the S&P 500 Index ended the year exactly where it started. Investors had to tolerate extreme volatility as the price for receiving the relatively attractive dividend yield that S&P 500 corporations paid in 2011. Last year's S&P 500 close was the smallest annual change since the 1970 close of 92.15 from 92.06 in 1969. More importantly, the S&P 500 Index posted a very respectable 10.8% increase to 102.09 in 1971, suggesting 2012 could be a strong year for the equity market if history chooses to repeat itself.

While the stock market may have ended the year unchanged, 2011 from our perspective was a story defined by two contrasting acts separated chronologically by the July 4 Independence Day holiday in the U.S. The first half of the year was an optimistic bullish chapter that took the S&P 500 Index as high as 1363.61 (8.4% year to date) as of April 29, and to 1353.22 by July 7. Up to this point, the health care, energy, consumer discretionary, and industrial sectors had led the market's advance. Investors' perceptions and attitudes toward risk and reward then reversed course in dramatic fashion shortly after the holiday weekend intermission. Optimism over the U.S. and global economy quickly morphed into fear of recession and potential crisis, headlined by deteriorating high-profile U.S. employment and Institute for Supply Management (ISM) Purchasing Managers Index (PMI) economic data, in addition to deteriorating global sovereign credit fundamentals. By the end of the first week in August, not only had the S&P 500 Index given up all of its 2011 gains, but the index was down 12% for the year to 1199.38.

Year-to-date sector performance until July 7 and thereafter clearly demonstrates the shift in investor perceptions that occurred just after mid-year 2011. Economically sensitive and cyclical sectors like the consumer discretionary, industrials, and materials sectors had respectable mid-year gains turn into single-digit gains or outright losses by year-end (see table 1). While the broader market ended the year unchanged, the traditionally defensive utilities, consumer staples, and health care sectors closed 2011 with impressive gains of 14.8%, 10.5%, and 10.2%,

respectively. Recession fears may have dissipated by year-end, but investors nonetheless remain defensively minded and refuse to reengage the more economically sensitive sectors. The tale of two economic scenarios occurring before and after mid-year 2011, in the end, resulted in very disparate equity market performances between the traditionally pro-cyclical and defensive sectors.

Table 1

S&P 500 Mid-Year Vs. Year-End Performance		
	July 7, 2011 (%)	Year-end 2011 (%)
Health care	14.0	10.2
Energy	13.3	2.8
Consumer discretionary	11.3	4.4
Industrials	9.8	(2.9)
Consumer staples	8.3	10.5
Utilities	8.0	14.8
Materials	5.6	(11.6)
Technology	5.5	1.3
Telecommunications	4.7	0.8
Financials	(1.9)	(18.4)
S&P 500 Index	7.6	0.0

Source: S&P Capital IQ.

The conclusion we have drawn from all the sound and fury in 2011 is that this year we will want to keep an open mind and not get too attached to any particular view. The U.S. economy turned out to be not nearly as strong as the PMI data suggested in the first quarter of 2011, but also not nearly as weak as the employment reports suggested in the third quarter. We still believe that the U.S. economy is building on the expansion cycle that began in early 2009, and will continue to do so, excluding extraordinary factors such as an earthquake and tsunami occurring in a major economic power and trading partner, or a sovereign debt and banking crisis in another.

We remain optimistic, as we were a year ago, over the growth prospects for the global economy and financial markets in 2012. We will however maintain our surveillance of the underlying conflict between improving macroeconomic fundamentals and the risks presented by policymakers' multiple attempts to calm investor anxiety over the simmering global sovereign debt crisis. The clearest indication that we think would signal that investors are putting the contrasting and indecisive 2011 experience behind them is a sustained reengagement of the cyclical economically sensitive sectors of the S&P 500 Index, and most notably, the much maligned and grossly underperforming financials sector. As the fundamental backdrop continues to improve, we envision the cyclical sectors to lead the stock market higher. Should the three-year-old economic recovery eventually succumb to another rendition of the 2008 global credit crisis, expect a down year for stocks with further outperformance from the defensive sectors. Here we go again!

Inside This Issue:

Macroeconomic Overview

In a year characterized by multiple economic and geopolitical crosscurrents and excessive inter-day volatility in global financial markets, it is surreal--but perhaps fitting--that the S&P 500 Index ended the year exactly where it started. The year was split; optimism over the U.S. and global economy quickly morphed into fear of recession and potential crisis, and the equity market reacted accordingly. After a year of volatility in 2011, we remain optimistic over the growth prospects for the global economy and financial markets in 2012. Nevertheless, the year reminded us of the underlying conflict

between improving macroeconomic fundamentals and the real underlying risks associated with the global sovereign debt crisis.

Economic And Market Outlook: Corporate Earnings

The expected growth rate of 7.19% for the fourth quarter would end the eight consecutive quarters of double-digit earnings growth for the S&P 500 Index, which began in the third quarter of 2009 and continued through the third quarter of 2011. Since the beginning of the calendar quarter on Oct. 3, analysts have cut estimates by more than 7 percentage points from 14.55%.

Leveraged Commentary And Data: 2011 Snapshot: Index Returns, Volume, Default Rates At A Glance

The S&P/LSTA Leveraged Loan Index returned 0.51% in December, pushing the full-year return for 2011 to 1.52%. It was a quiet finish to an eventful year that saw the index post both its largest monthly loss since the dying days of 2008 (a 4.4% decline in August) and its largest monthly gain since the rollicking bull market of 2009 (a 2.89% increase in October).

R2P Corporate Bond Monitor

Amid improved economic data in the U.S. and lessened concerns regarding the European debt crisis, risk-reward profiles--as measured by average Risk-to-Price (R2P) scores--improved across the board from Dec. 15 to Jan. 4 in the fixed-income market.

Market Derived Signal Commentary: The CDS And Equity Markets Tell Different Stories

The 2011 equity performance prompted the Global Markets Intelligence (GMI) research team to search our credit default swap (CDS) database for the performance of CDS spreads over the past year. U.S. corporate spreads, on average, widened 270 basis points (bps) from Jan. 3, 2011, to Jan. 3, 2012, according to CMA DataVision, indicating the credit market's view of rising risk. But performances varied significantly from sector to sector.

Capital Market Commentary: IPO Pricings Are Typically Slow In January

A high backlog of IPOs does not necessarily suggest a fast start out of the gate for new issues. The last time there was a similar backlog at the end of a calendar year (227 IPOs awaiting pricing at the end of 2011, according to S&P Capital IQ data) was at the end of 2007 (210 IPOs). In January 2008, just two IPOs managed to get completed.

S&P Index Commodity Commentary: Energy Vs. Non-Energy

Commodity prices, as measured by the S&P GSCI Index, fared relatively well in 2011 due to strength in energy. The energy sector has continued to lead commodity price gains early in 2012 due to potential supply disruptions and increasing demand from developing countries, but to the increasing peril of the fragile economies of the developed countries.

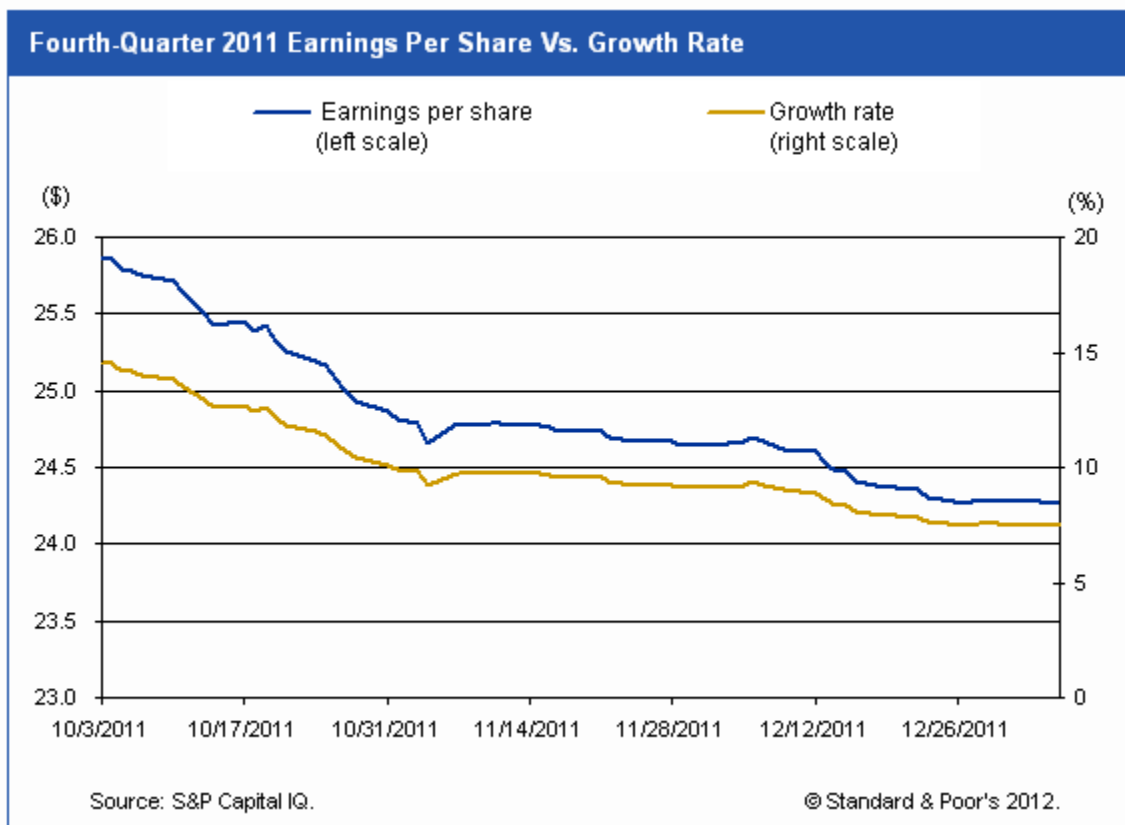
Bond Commentary: An International Take On Bonds

As U.S. investors in an uncertain economic environment look to increase the yield of their portfolios without taking on more risk, international bonds may now be in an excellent position to achieve these goals while simultaneously adding a degree of diversity to U.S.-weighted holdings.

Economic And Market Outlook: Corporate Earnings

With the unofficial start of the fourth-quarter earnings season next week, the S&P Capital IQ consensus currently expects earnings to increase by 7.19% from the year-ago period (see chart 1). This expected growth rate would end the eight consecutive quarters of double-digit earnings growth for the S&P 500 Index, which began in the third quarter of 2009 and continued through the third quarter of 2011. Since the beginning of the calendar quarter on Oct. 3, analysts have cut estimates by more than 7 percentage points from 14.55%. While this decline is larger than we've seen for any other quarter in 2011, it is consistent with last year's trend of significant downward revisions to quarterly earnings expectations in the weeks leading up to earnings reporting season, with corporations inevitably beating final expectations. For example, last quarter analysts trimmed the estimated growth rate by 4.5 percentage points to 12.37% from 16.88%, but positive surprises propelled the final growth rate above initial expectations to 17.67%. However, in an uncertain global economic environment driven by the ongoing European debt crisis, there is much doubt about a ninth consecutive quarter of double-digit growth.

Chart 1

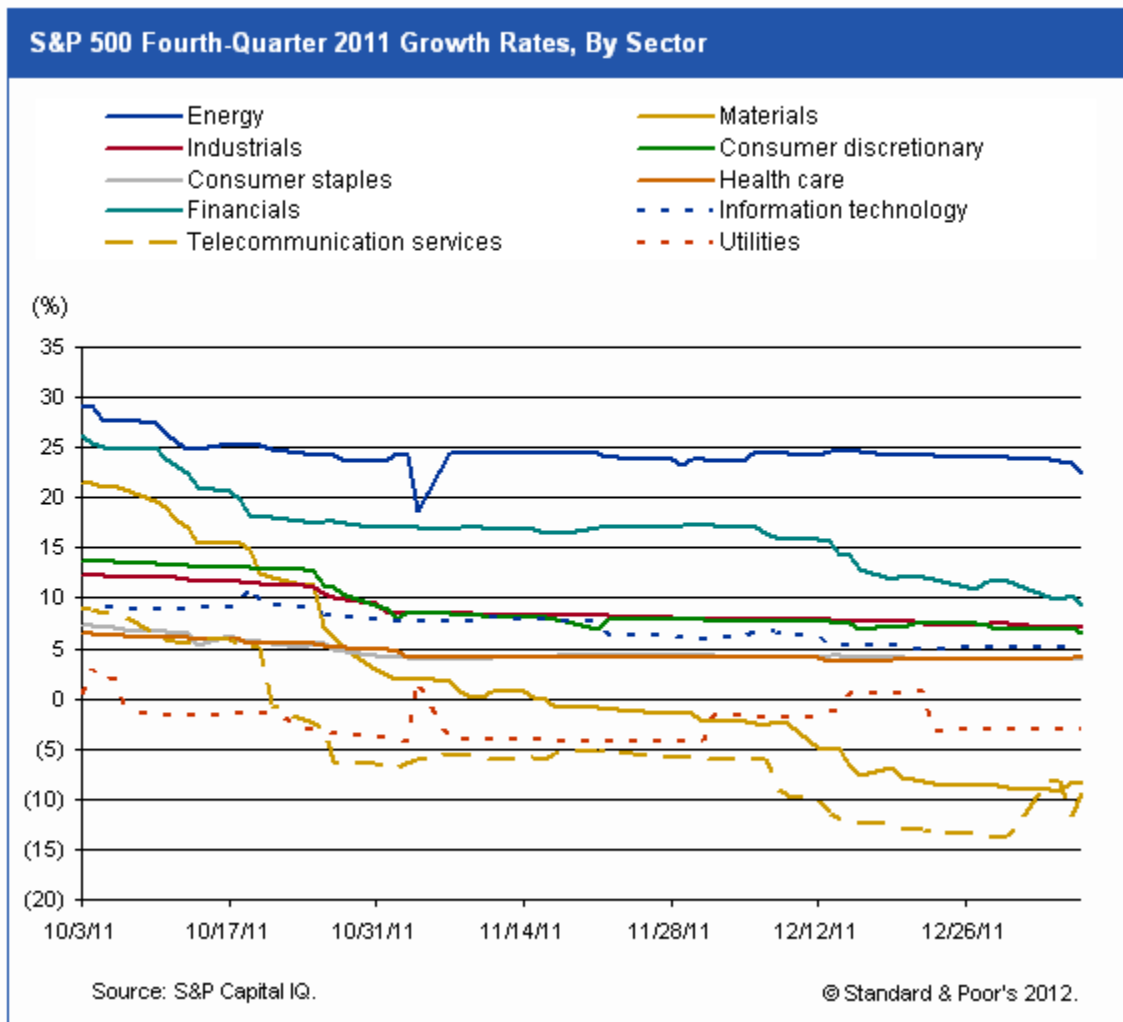


Once again, we expect strong growth in the energy sector (22.44%) with support from high oil prices (see chart 2). West Texas intermediate crude closed above \$103 a barrel on Jan. 4, compared with \$90 a barrel in the year-ago period. The financials sector is expected to report earnings growth of 9.24%; the sector performed well during the first half of the year but was hit hard last quarter when poor results from The Goldman Sachs Group Inc. resulted in third-quarter growth of only 4.54%.

Estimates for the materials sector, which drove growth rates for much of 2011, have been cut the most since the beginning of the calendar quarter, to an expected 8.48% decline from 21.48%. This is due to a decrease in commodity prices as well

as a softening of demand for raw materials from emerging markets. Estimates for the telecommunications sector, which analysts expect will post the largest year-over-year decline (9.41%), have dropped more than 20% in the last few months. Analysts expect earnings for AT&T Inc. and MetroPCS Communications Inc. to report year-over-year declines of 16.17% and 22.30% due to higher than average churn rates.

Chart 2



During the first half of the year, a large number of companies that exceeded estimates did so by expanding international operations, particularly in Asia and Latin America. With growth in the U.S. economy continuing at a slow pace and the debt crisis worsening in Europe, many companies increased their exposure to emerging markets to capitalize on plentiful growth opportunities and offset weakness in other regions. During the second half of the year, we've seen growth in these markets slightly moderate, raising concerns about future opportunities. Despite this, companies such as Apple Inc., Marriott International Inc., and NIKE Inc. said in the third quarter that they still see strength in Asia and other emerging markets. Further, Coach Inc., International Paper Co., and Parker Hannifin Corp. said that even if growth in these markets moderated further, they would still consider them worthy of increased operational expansion. So far, only 26 companies have reported results for the fourth quarter, but a handful of companies, including Accenture PLC, Best Buy Co. Inc., and Oracle Corp. are reporting higher growth in international segments than in the U.S. For example, General Mills Inc. reported revenue growth of 55% internationally but 3% domestically.

One concern we have about the fourth quarter is the relatively low number of companies that have beat estimates. While it is still very early in the season, only 13 of the 26 companies have beat estimates, while nine have missed and four have met, for an upside surprise rate of 50% (see table 2). This figure is much lower than the historical average of 62% and is also lower than the 70% rate seen this early in the first three quarters of 2011. If the quarter ends with an upside surprise rate of 50%, it would represent the lowest percentage of companies to have topped estimates in 10 years of collecting data.

Table 2

Actual Vs. Estimates			
Quarter	Beat (%)	Miss (%)	Match (%)
4Q2010	68	24	8
1Q2011	67	23	10
2Q2011	70	20	10
3Q2011	71	21	8
4Q2011	50	35	15

Source: S&P Capital IQ.

While we acknowledge the possibility that companies could surprise the market once earnings season is in full swing next week, this doesn't look likely when judging company guidance. Thus far, 108 companies have provided guidance for the fourth quarter--68 of those are negative, while 27 are positive, resulting in a negative-to-positive (N/P) ratio of 2.52 (see table 3). This is the highest N/P ratio we've seen since the fourth quarter of 2008 (3.7), and much higher than the historical average of 2.0 and the average for the first three quarters of this year of 1.52.

Table 3

Company Guidance								
Type	1Q 2011		2Q 2011		3Q 2011		4Q 2011	
	Count	Percent (%)	Count	Percent (%)	Count	Percent (%)	Count	Percent (%)
Higher	46	35.7	42	37.5	33	30.3	27	25
In-line	12	10.1	14	12.5	14	12.8	13	12
Lower	61	51.3	56	50	61	60	68	63
Total	119		112		109		108	
N/P ratio	1.33		1.33		1.9		2.52	

Source: S&P Capital IQ.

Next week, questions about the health of corporate earnings will begin to be answered, with Alcoa Inc. kicking off the season on Jan. 9. Traditionally considered an earnings bellwether, analysts expect the company to report \$0.01 per share for the fourth quarter, down 95% from \$0.21 reported a year ago. As Alcoa missed earnings expectations in both the second and third quarter, it is quite possible that the company could report a loss, which would be its first since the second quarter of 2009. Three other companies are expected to report next week: Lennar Corp. (flat at \$0.17), SUPERVALU Inc. (flat at \$0.24), and JPMorgan Chase & Co. (\$0.95 versus \$1.12 in 2010).

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Leveraged Commentary And Data: 2011 Snapshot: Index Returns, Volume, Default Rates At A Glance

The S&P/LSTA Leveraged Loan Index returned 0.51% in December, pushing the full-year return for 2011 to 1.52%. It was a quiet finish to an eventful year that saw the index post both its largest monthly loss since the dying days of 2008 (a 4.4% decline in August) and its largest monthly gain since the rollicking bull market of 2009 (a 2.89% increase in October).

The 2011 roller-coaster ride was hardly unique to the loan market. Risk assets generally followed Europe's changing fortunes, which shifted regularly and with great effect. The S&P 500 Index, for instance, ended 2011 right where it began. In between, the index reached a high of 1,364 on April 29 (an 8.4% gain) and a low of 1,099 on Oct. 3 (a 12.6% loss). The Bank of America Merrill Lynch High-Yield Master Index, likewise, posted a year-to-date high return of 6.36% on July 26 and a low tick of 4% on Oct. 4. Like returns, loan volume generally tracked the mood of the market (see table 4).

Table 4

	January - July	August - September	October - December		January - July	August - September	October - December
	Average monthly loan volume (bil. \$)				Average new-issue first-lien institutional pricing		
All	41.1	13.0	19.7	Spread (L+)	435.3	575.0	514.9
Repricings	9.6	0.0	1.3	OID (%)	99.19	96.85	97.78
Dividend	5.0	0.0	0.4	Floor (bps)	135.9	142.0	136.6
LBO	4.5	3.1	4.8	% with floor (%)	98	100	100
A-to-E	6.3	2.2	1.7	Yield to maturity (%)	6.02	8.21	7.21
Covenant-lite	7.2	1.3	1.3	% flex up/flex down (%)	24/34	50/14	9/40
	Average index price				Average monthly return		
Performing index	96.60	91.45	92.12	Performing index (%)	0.40	(2.01)	0.97
BB index	99.67	95.60	97.52	BB index (%)	0.28	(1.10)	1.03
B index	96.50	91.76	92.72	B index (%)	0.52	(2.35)	1.15
CCC index	85.43	74.99	71.47	CCC index (%)	0.41	(4.84)	0.27
	Average new-issue first-lien institutional year to month, by corporate rating				Average monthly technicals data (bil. \$)		
BB ratings (%)	4.47	6.67	4.74	CLO issuance	1.0	0.6	1.5
B ratings (%)	6.03	8.72	7.52	Mutual fund inflows	3.8	(4.1)	(0.7)

Source: Standard & Poor's LCD.

Other headline numbers for 2011: volume

Loan volume rebounded to \$59 billion in the fourth quarter, from a 1.5-year low of \$54 billion in the third quarter. The gain was driven by pro rata volume. Institutional issuance, however, dipped further during the final three months of the year, to \$26 billion from \$28 billion. For all of 2011, activity totaled \$373 billion, including \$232 billion of institutional loans. Those figures are up 60% and 46%, respectively, from 2010, and they are the highest since 2007's record tally of \$535 billion/\$387 billion.

Investor market

With market conditions improving, traditional accounts--loans mutual funds and CLO managers--ramped up their collective share of institutional loan allocations to 56%, from 49% in the third quarter. At the same time, the share taken by relative-value players dropped to 33% from 39%. Moreover, the number of institutional accounts LCD tracked grew to 237 during the final three months of 2011, from 229 three months earlier, reflecting the fact that a few new nontraditional players waded into the loan market for high-octane paper.

Default rates

There were no defaults among S&P/LSTA Index loans in December. The third straight month with such a result left the loan default rate frozen at a 54-month low of 0.17% by principal amount and a 48-month low of 0.62% by number of loans, versus 1.87% and 2.86%, respectively, in December 2010. To put today's level in context, the rate by amount is mere microns above the all-time low of 0.15% from June 2007. That record could fall in January, when, if there are no defaults, the rate will ease to 0.14%.

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R2P Corporate Bond Monitor

The New Year kicked off with upbeat economic data in the U.S. The ISM's manufacturing index released on Tuesday rose to 53.9 in December from 52.7 a month before, higher than the economist median expectation of 53.5. A reading of 50 signals growth. Commerce Department data also showed construction spending climbed 1.2% in November. The ISM's report on U.S. manufacturing added to data showing stronger factory activity in China, the U.K., Switzerland, India, and Australia. Bookings for U.S. factory goods climbed 1.8% in November after a revised 0.2% drop the prior month, the most in four months, according to the Commerce Department. The U.S. employment situation continued to improve in December after the Bureau of Labor Statistics reported that 200,000 new jobs were created in the final month of 2011 and that the U.S. unemployment rate surprisingly declined to 8.5%, the lowest level since February 2009.

Meanwhile, European leaders have worked to flesh out their plan to end the debt turmoil threatening to drag the region back into recession. The International Monetary Fund may cut its 2012 global growth forecast this month after lowering it to 4% in September, when it predicted "severe" repercussions if Europe were to fail to contain its crisis.

In the fixed-income market, risk-reward profiles--as measured by average Risk-to-Price (R2P) scores--improved across the board from Dec. 15 to Jan. 4 (see tables 5 and 6). In the U.S., scores improved by 22%, on average, due to declines in the probability of default (PD) and bond price volatility of 39% and 6%, respectively. In Europe, although option-adjusted spreads (OAS) tightened by 11 bps, the scores improved by 23% due to a decrease in the PD and bond price volatility of 20% and 32%, respectively.

Table 5

North American Risk-Reward Profiles By Sector--Average R2P Score And Components Changes				
	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	30	(13)	(52)	(6)
Consumer staples	18	1	(41)	(5)
Energy	19	4	(45)	(8)
Financials	9	(2)	(37)	(18)
Health care	27	(5)	(40)	(11)

Table 5

North American Risk-Reward Profiles By Sector--Average R2P Score And Components Changes (cont.)				
Industrials	37	(3)	(44)	(4)
Information technology	14	23	(25)	(3)
Materials	35	2	(41)	1
Telecommunication services	18	(19)	(32)	(5)
Utilities	13	4	(29)	(2)

Change as of Jan. 4, 2011, from Dec. 15, 2011. Source: S&P Capital IQ.

Table 6

European Risk-Reward Profiles By Sector--Average R2P Score And Components Changes				
	Scores (%)	OAS (bps)	PD (%)	Bond price vol. (%)
Consumer discretionary	20	5	(22)	13
Consumer staples	24	(4)	1	(27)
Energy	23	5	(11)	(30)
Financials	27	(6)	(20)	(38)
Health care	14	(58)	(44)	(39)
Industrials	21	(4)	(9)	(45)
Information technology	36	(27)	(8)	(51)
Materials	33	(16)	(58)	(26)
Telecommunication services	19	5	(24)	(36)
Utilities	14	(6)	(9)	(38)

Change as of Jan. 4, 2011, from Dec. 15, 2011. Source: S&P Capital IQ.

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Market Derived Signal Commentary: The CDS And Equity Markets Tell Different Stories

After a volatile year in which an earthquake and tsunami devastated Japan, tornadoes and hurricanes wreaked havoc across a swath of the U.S., a sovereign debt crisis spread across Europe, and recession fears at home and abroad rose and fell, the S&P 500 Index managed to close out 2011 virtually unchanged at 1257.60. Sector performance within the index varied, however, from a year-end gain of 14.8% for the utilities sector, to an 18.4% loss for the financials sector.

The 2011 equity performance prompted the Global Markets Intelligence (GMI) research team to search our credit default swap (CDS) database for the performance of CDS spreads over the past year. U.S. corporate spreads, on average, widened 270 basis points (bps) from Jan. 3, 2011, to Jan. 3, 2012, according to CMA DataVision, indicating the credit market's view of rising risk (see table 7). But performances varied significantly from sector to sector.

Table 7

Average CDS Spread		
	CDS (average, in bps)	Year-over-year change (%)
Consumer discretionary	656*	*467
Consumer staples	138	88
Energy	106	39
Financials	350	211
Health care	203	**61
Industrials	378***	54
Information technology	135	17.1

Table 7

Average CDS Spread (cont.)		
Materials	159	1.5
Telecommunications	497	67
Utilities	81	48

*Excludes Eastman Kodak (including Eastman Kodak, consumer discretionary spread widened 950%, and average bps was 4,201). **Excludes HCR Health Care LLC (Including HCR, spread widened 164%). ***Excludes YRC Worldwide (including YRC, average spread totaled 1,274 bps). Source: CMA DataVision.

With a flight to quality in 2011, it was not a surprise to see the relatively low average spreads for the utilities and consumer staples sectors. As we mentioned, utilities posted the best returns in the S&P 500 Index, and consumer staples finished the year up 10.5%. Health care returned 10.2% in the equity market, but the average spread indicates the credit market has a less bullish view of the traditionally defensive sector; at 203 bps, the spread is 65 bps wide of consumer staples and 122 bps wide of utilities. The telecommunications sector, which investors often view as a utility, had the widest spread of all 10 sectors at 497 bps, and shares in the sector rose only 0.8% on the year.

Financials, as expected, declined 18.4% in the equity market and widened 211% over the past year to 350 bps, as fears over U.S. banks' exposure to sovereign debt weighed heavily on the sector. Materials, on the other hand, widened only 1.5% to a respectable 159 bps, but shares in the sector lost 11.6% as earnings expectations collapsed in the fourth quarter. Analysts polled by S&P Capital IQ expect a decline of 9.2% in year-over-year fourth-quarter earnings, after growth of 54%, 52%, and 31% in the first, second, and third quarters, respectively.

As we enter 2012, the GMI research team expects cyclical sectors such as energy, consumer discretionary, and financials to lead gains in the S&P 500 Index as the slow-but-sustained economic recovery that we expect continues. But an exogenous shock could change all that, as we saw in 2011. And we think fourth-quarter results will be pivotal to CDS spreads and share prices alike in the early part of the year, with better-than-expected results galvanizing investors and lower-than-expected results leading to declining risk tolerance.

Since the equity and credit markets often have differing opinions on sector strengths and weaknesses, we think cyclical and defensive investors alike may want to periodically monitor the CDS market in addition to the equity market for the latest trading trends in each sector to help determine the best investment opportunities to suit their particular objectives.

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Capital Market Commentary: IPO Pricings Are Typically Slow In January

IPOs

As the new year begins, expectations for a continuation of 2011's pace of initial public offerings (IPOs) may be somewhat muted. The GMI research team examined the pace of completed offerings in each January since 2000 and found that two or fewer IPOs came to market in half of the observations. Even a high backlog of IPOs does not necessarily suggest a fast start out of the gate for new issues. The last time there was a similar backlog at the end of a calendar year (227 IPOs awaiting pricing at the end of 2011, according to S&P Capital IQ data) was at the end of 2007 (210 IPOs). In January 2008, just two IPOs managed to get completed (see charts 3 and 4). With that in mind, the wait may continue for later in the month, if not until February, for IPO activity to increase.

Chart 3

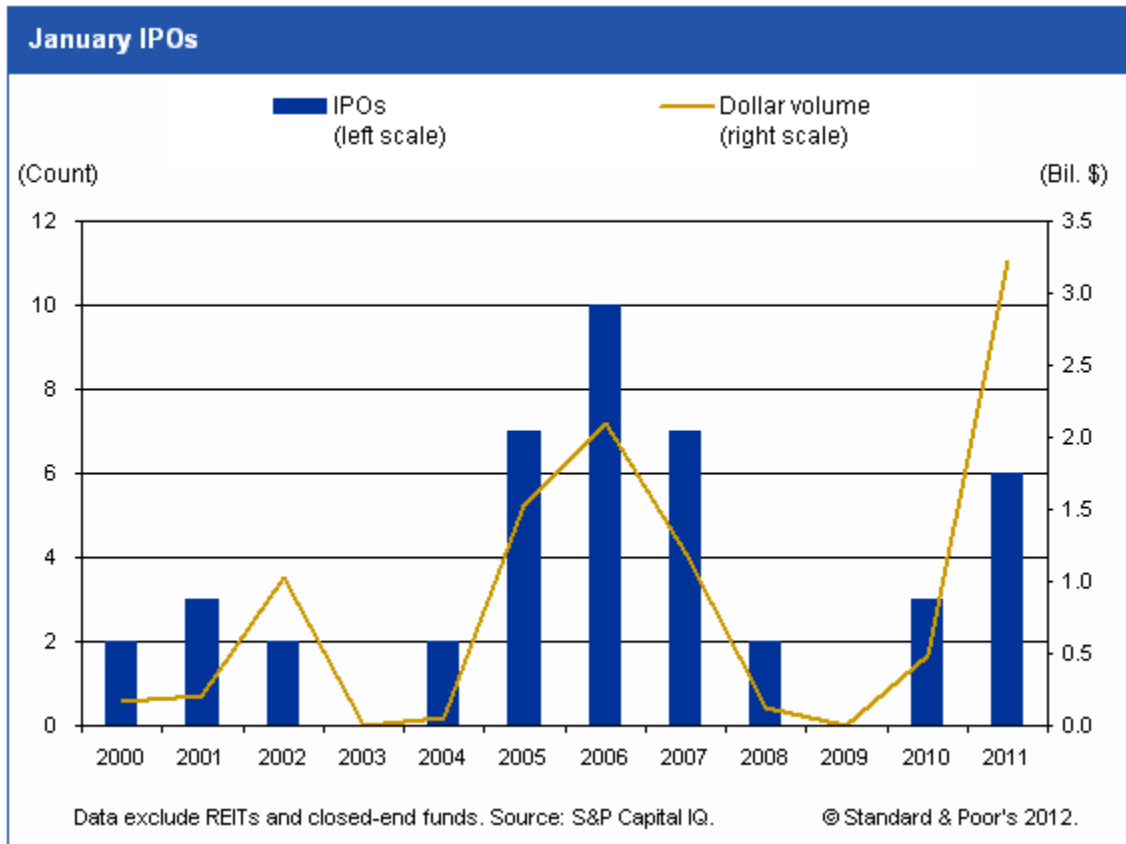
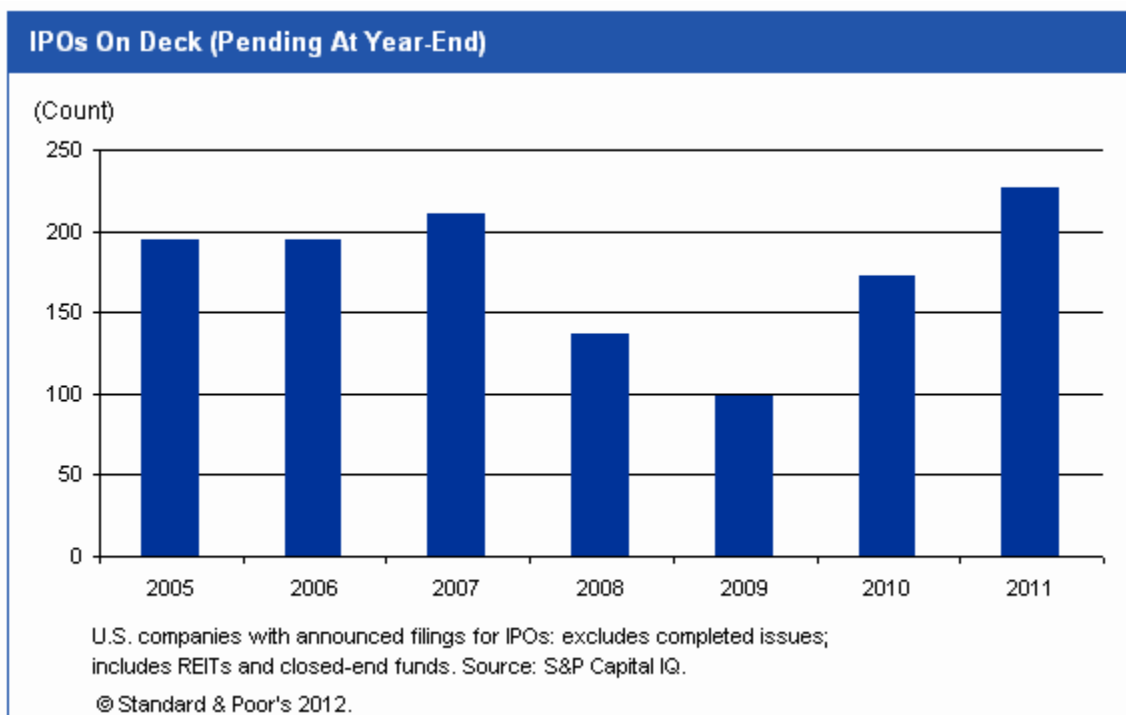


Chart 4

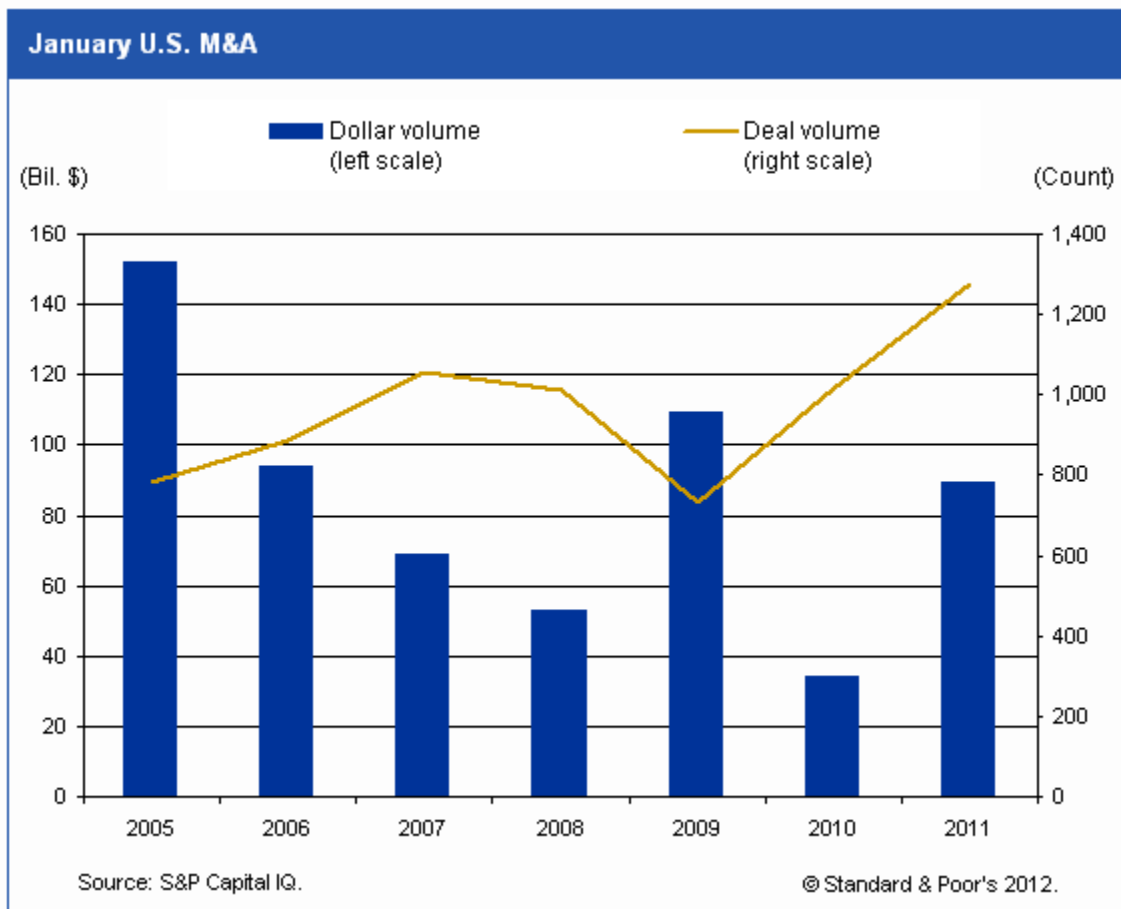


M&A

With nearly \$1 trillion of announced U.S. M&A deals occurring in 2011, January deal activity opened with a couple of notable transactions in the energy sector. First, Chinese oil and gas company Sinopec signed an agreement to acquire a 33.33% stake in various shale interests from Devon Energy Corp. for \$900 million in cash and the assumption of \$1.6 billion in additional developmental drilling costs. That transaction ranks as the second largest ever Chinese acquisition in the U.S. market, according to S&P Capital IQ data. Also of note, French energy giant Total S.A. acquired a 25% stake in an Ohio-based shale deposit from Chesapeake Energy Corp. and EnerVest Ltd. for \$2.3 billion. Those transactions reflect a continuation of last year's surge in foreign acquisitions of U.S. energy assets, which reached \$46 billion, the second busiest year ever for such deals.

Looking at January trends, recent activity shows that in four of the past five years, more than 1,000 U.S. M&A deals were announced, with an average of \$70 billion in transactions (see chart 5). With companies maintaining high corporate cash levels and seeking growth opportunities, the pace of dealmaking should continue at a vigorous level in the near term.

Chart 5



Debt

Domestic corporate debt CUSIP orders held firm in December, with 823 requests. For full-year 2011, more than 10,300 identifier orders were sought for this asset class. In the municipal field, despite a strong fourth-quarter with 3,965 domestic municipal CUSIP requests, full-year volume dropped by more than 18% to 13,317, compared with more than

16,000 CUSIP requests in 2010. December results revealed that 1,261 CUSIPs were sought for domestic municipal debt issues, marking the second busiest month in the second half of 2011. Meanwhile, while short-term municipal notes for 2011 edged 2% higher from prior-year results, long-term municipal note CUSIP requests were nearly halved in 2011. International debt CUSIP orders slipped in December, likely reflecting the ongoing anxiety facing European financial markets. International debt CUSIP orders for the sixth consecutive month failed to top the 100 mark, based on recent results.

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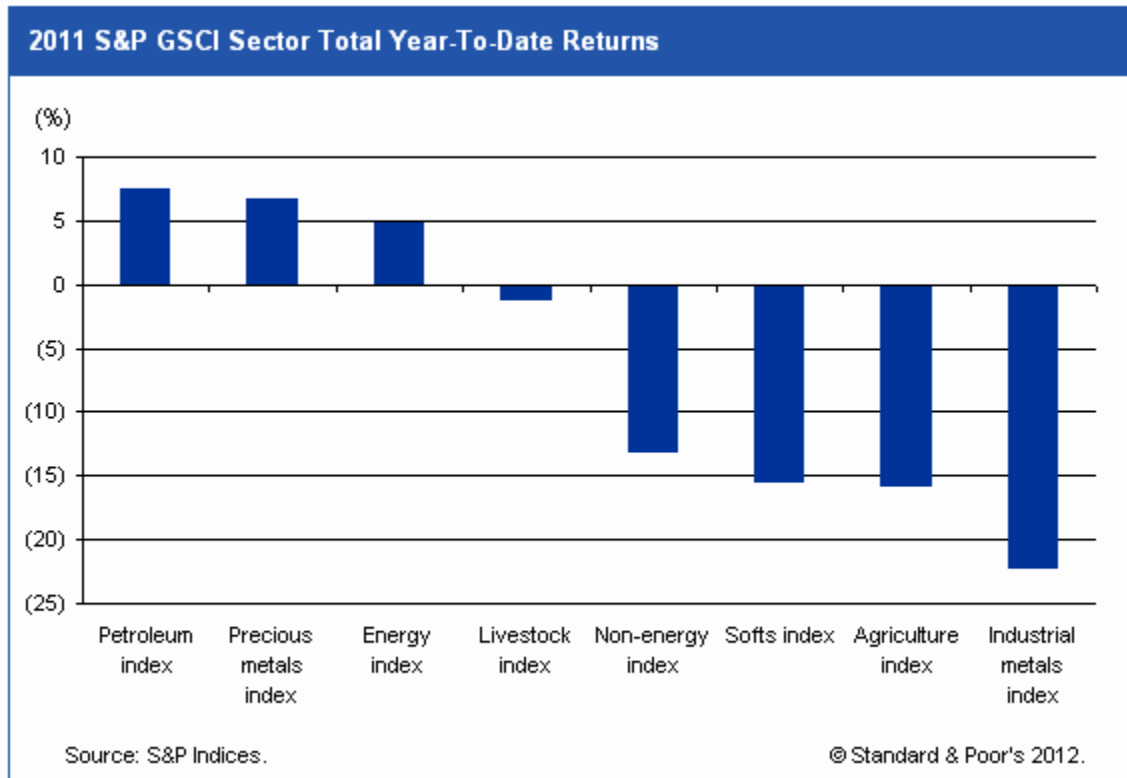
S&P Index Commodity Commentary: Energy Vs. Non-Energy

The 2011 year was a bad one for dictators, terrorists, bankers, and global equities but the S&P GSCI Index fared relatively well, ending the year with a modest decline of 1.18% on the back of a 2.11% decline in December. Early in 2012, the strength in energy continued as measured by the 5.00% year-to-date increase in the S&P GSCI Petroleum Index as of Jan. 4 (see chart 6). In 2011, one of the most significant themes was the dichotomy between strength in energy prices and weakness in most other commodities, with the notable exception of gold. Led by petroleum, as measured by the 7.55% 2011 increase in the S&P GSCI Petroleum Index, the S&P GSCI Energy Index increased 4.86% in 2011. By comparison, the S&P GSCI Non-Energy Index ended 2011 with a decline of 13.27%.

The industrial metals sector led decliners with a loss of 22.33% in the S&P GSCI Industrial Metals Index. The last time the S&P GSCI Energy Index ended the year with a gain, while the S&P GSCI Industrial Metals Index declined, was in 2007. The precious metal sector was the best-performing sector in 2011, as measured by the increase of 6.63% in the S&P GSCI Precious Metals Index, but by the end of December, gold investors took profits. Silver earned its nickname as the "devil's metal" in 2011, with the S&P GSCI Silver Index down 10.15%.

Backwardation and energy prices reemerged as every S&P GSCI petroleum commodity ended 2011 with backwardation-shaped futures term structures (when the one-year futures contract trades below near-term prices). Ironically, energy commodities earned distinctions as the best and worst performers in 2011, as measured by the year-to-date gain of 20.20% for the S&P GSCI Gasoil Index, compared with the 44.54% decline for the S&P GSCI Natural Gas Index. Tight supply and demand conditions for the petroleum products helped to boost returns, while ample supplies of North American natural gas continued to pressure natural gas index returns. Wheat was one of the worst-performing single commodity indices in 2011, as measured by the 33.98% decline in the S&P GSCI Wheat Index. Following sharp price increases in 2010, the agriculture sector in 2011 was characterized by bringing-on-supply in 2011.

Chart 6



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Bond Commentary: An International Take On Bonds

As U.S. investors in an uncertain economic environment look to increase the yield of their portfolios without taking on more risk, international bonds may now be in an excellent position to achieve these goals while simultaneously adding a degree of diversity to U.S.-weighted holdings.

International bonds: Why invest?

Government bonds issued outside the U.S. account for approximately 72% of the global government bond market, while international (non U.S.) corporate bonds represent nearly 52% of the global corporate bond market.

With respect to the international government bond market, developed markets (as classified by the Bank of International Settlements), account for the vast majority of international government bonds outstanding (more than 80%). Developed market treasury bonds are most often denominated in the issuing country currency, and prior to the European financial crisis, were generally considered to have a low chance of default. With higher coupon rates on average, international treasury bonds have historically provided higher yields compared with U.S. treasuries.

On the corporate side, approximately 75% of international corporate bonds are issued in G-10 (ex U.S.) developed market currencies. Corporate bonds, regardless of their country of issuance, carry a certain degree of credit risk, but often compensate for this risk with higher yields.

Diversification benefits

Historically, international bonds have demonstrated a relatively low correlation with the domestic and global equity marketplace, as well as with domestic fixed-income investments (see table 8). Based on the findings, the potential long-term diversification effects of including international bonds in a U.S. investment portfolio could be substantial and are worth further investigation. International bonds also offer additional diversification within a bond-only allocation, reducing exposure to market variations of a single currency or issuer.

Table 8

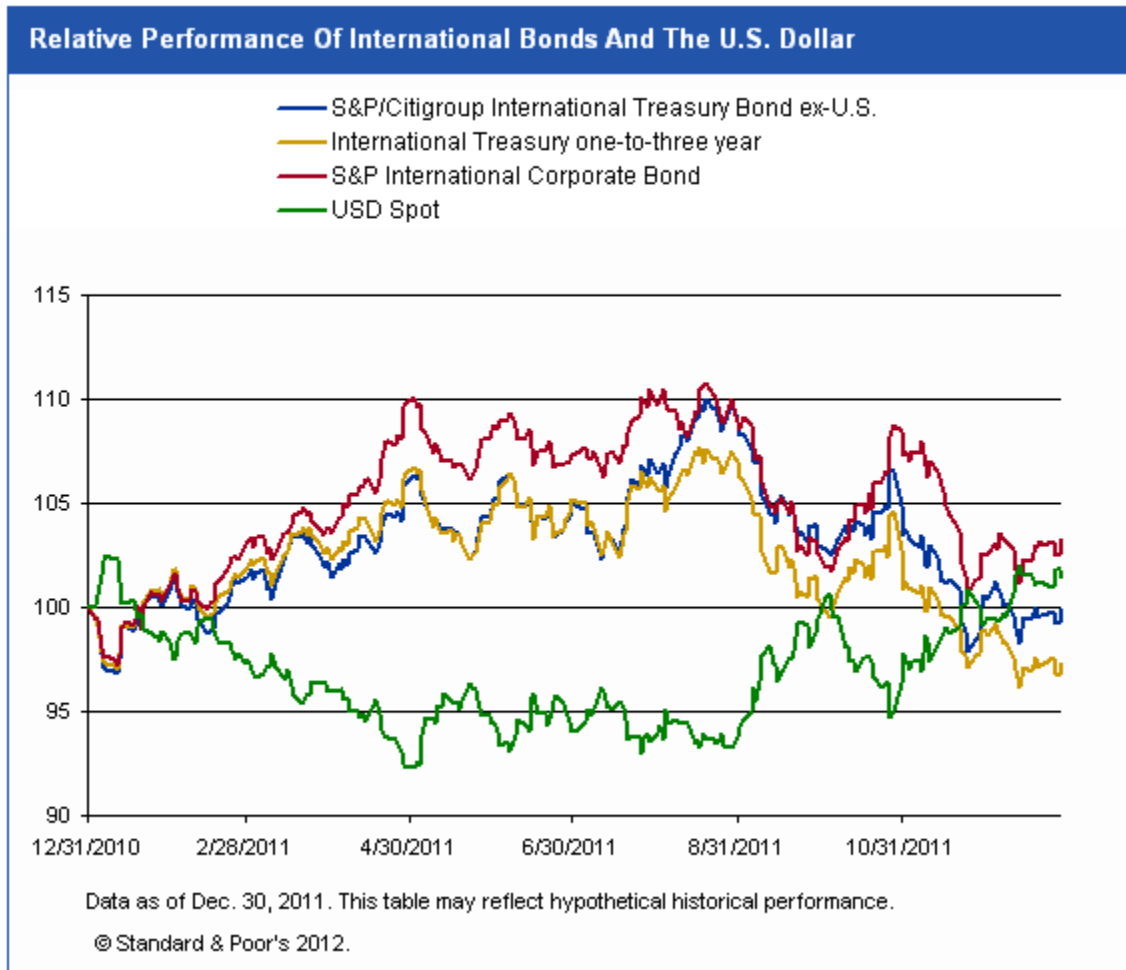
Risk And Return Profile: Selected Domestic And International Asset Classes							
January 2002 to December 2011							
	S&P International Corporate Bond Index	S&P/Citigroup International Treasury Bond Ex-U.S. Index	S&P 500 TR Index	Global BMI (Ex-U.S.) Index	S&P/BGCantor U.S. Treasury Bond Index	S&P/BGCantor U.S. Treasury Bill Index	
Annualized return (%)	8.27	8.16	2.92	7.43	5.14	1.97	
Standard deviation (%)	10.20	9.70	15.90	19.50	4.20	0.50	
Risk ratio	0.81	0.84	0.18	0.38	1.23	3.88	
Maximum drawdown (%)	(18.10)	(13.60)	(50.90)	(57.80)	(3.90)	0.00	
Correlation matrix							
International corporate bonds	1	0.93	0.34	0.55	0.32	(0.04)	
International treasuries		1	0.22	0.42	0.47	0.04	
U.S. stocks			1	0.89	(0.33)	(0.08)	
International stocks				1	(0.26)	(0.05)	
U.S. treasuries					1	0.12	
U.S. T-bills						1	

Risk ratio is defined as annualized return divided by standard deviation. Maximum drawdown is defined as maximum loss from a market peak to a market bottom during the sampled period. Data as of Dec. 30, 2011. This table may reflect hypothetical historical performance.

Opportunity to manage dollar risk

International bonds also offer a way to gain currency exposure. A weakening U.S. dollar adds to total return after currency translation, while a strengthening U.S. dollar reduces total return after the effects of currency translation. Chart 7 shows that international bond markets are inversely correlated with the movements of the U.S. dollar, as well as the fact that a high degree of the variance in international bond returns is due to currency movement.

Chart 7



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