S&P CAPITAL IQ
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Lookout Report
from Global Markets Intelligence

Unrelenting Weather, The U.S. Economy, And The Outlook for 2014 Earnings--We're Looking Forward To The Winter Thaw

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The Lookout Report is a compendium of current data and perspectives from across S&P Capital IQ and S&P Dow Jones 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.

As we wind down what has turned out to be a fairly impressive fourth-quarter 2013 earnings season for S&P 500 corporations (7.9% growth versus the 5.3% growth that analysts expected at the start of earnings season), Global Markets Intelligence (GMI) Research finds itself pondering a question that we first presented back in early November (see Lookout Report titled, "Is The U.S. Economy Strong Enough To Generate S&P 500 Earnings Of $120 Per Share In 2014?," published Nov. 1, 2013). Severe winter weather has been a significant, but largely unquantifiable negative influence on the U.S. economy ever since we first learned that it likely contributed to the weaker-than-anticipated December employment report. The Bureau of Labor Statistics stated that 273,000 individuals were unable to work in December because of weather, the highest figure seen since 1977.

The ensuing string of extreme cold temperatures and disruptive winter storms, in turn, is likely casting some degree of doubt on the outlook for calendar-year 2014 S&P 500 earnings. According to consensus data aggregated by S&P Capital IQ, analysts' expectations for 2014 earnings have slipped to $118.25 per share from $121.25 at the start of November, just before a steady repetition of snow and ice storms became an issue for the economy and prospective earnings. So now we are wondering if the economy is still strong enough to deliver S&P 500 earnings of at least $118 per share this year, weather aside.

The question of how much the weather is influencing the economy and earnings would normally be substantially less noteworthy. However, by some measures, particularly those associated with U.S. housing, the economy was already showing potential early-warning signs of vulnerability. One clear cut example of this situation is the latest release of the mortgage applications-to-purchase index from the Mortgage Bankers Association of America (MBA).

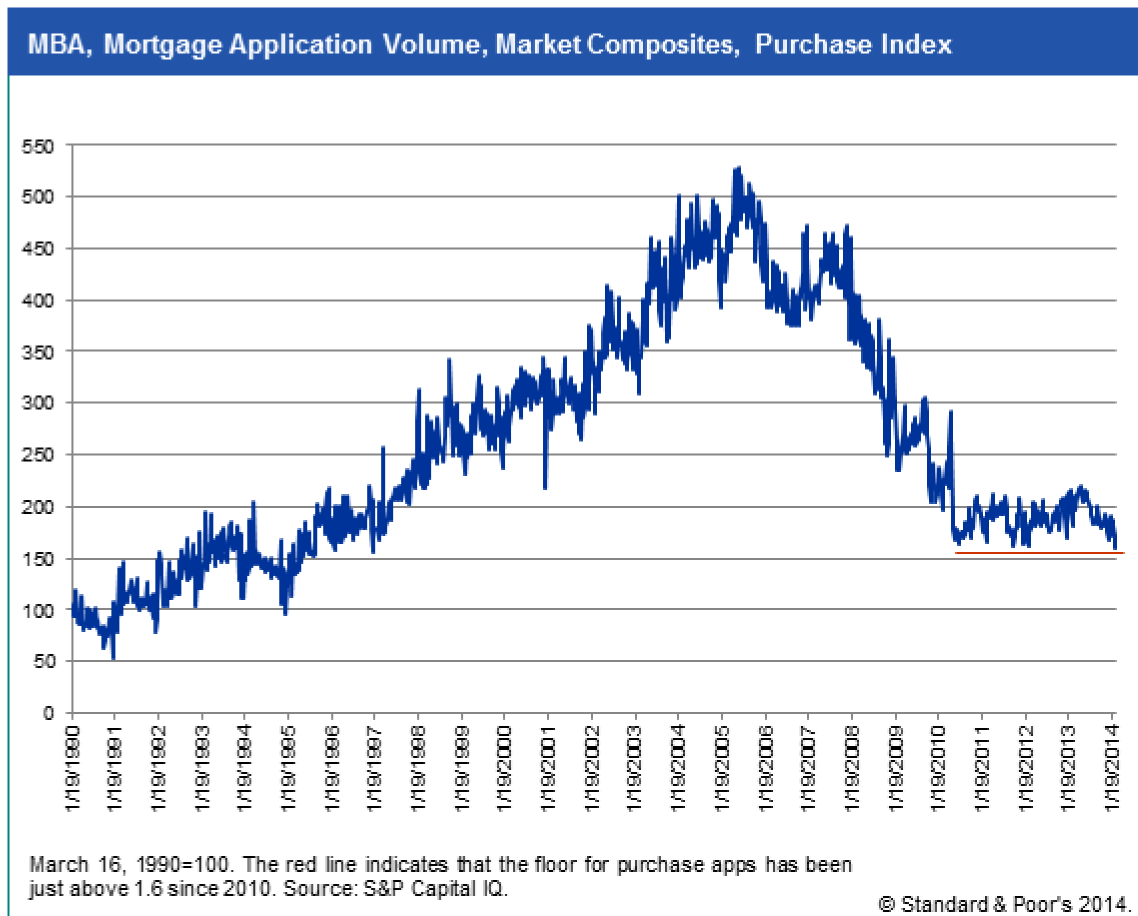
As of the week of Feb. 14, the MBA's to-purchase index dropped almost 11 points to 160.7, which is the weakest reading recorded since the week of Dec. 27, 1996. This decline to the lowest level seen in just over 17 years is obviously being influenced by winter storms, but this does not change the fact that the applications-to-purchase index has been steadily declining since mid-year 2013 after Fed Chairman Bernanke started preparing the financial markets for rising interest rates and the inevitability of Fed tapering (see chart 1). Other economic indicators

such as retail sales, thankfully, are less worrisome than the housing related data appear to be. While retail sales have recently posted the first back-to-back monthly declines seen since June 2012, they are following the November tally of $430.1 billion, which represented the highest level on record (see chart 2).

In our previous edition of the Lookout Report, GMI Research stated that we are once again paying particularly close attention to the housing market. Anticipation of a strong seasonal rebound in the housing market, including an accelerating pace of new home construction, remains a key element in our ongoing bullish outlook for the economy, equity, and credit risk spread-based markets. Sustained weak readings of the MBA mortgage applications-to-purchase index along the lines of what was reported earlier this week would definitely be inconsistent with our market view. Weak MBA data would also be inconsistent with 8% S&P 500 earnings growth in 2014, in our opinion.

Any further non-weather related weakness in high profile economic indicators would result in further downward revisions to fairly bullish forward earnings expectations, which would in all likelihood cause investors to reconsider the relatively optimistic market valuations currently assigned to stocks. The current S&P 500 price/earnings multiple of 15.6x calendar-year 2014 earnings of $118.25 is nearly double the expected calendar-year earnings growth rate of 7.9% (PEG 1.975), suggesting little if any room for big negative economic data surprises once the U.S. economy starts to emerge from its winter thaw.

Chart 1



March 16, 1990=100. The red line indicates that the floor for purchase apps has been just above 1.6 since 2010. Source: S&P Capital IQ.

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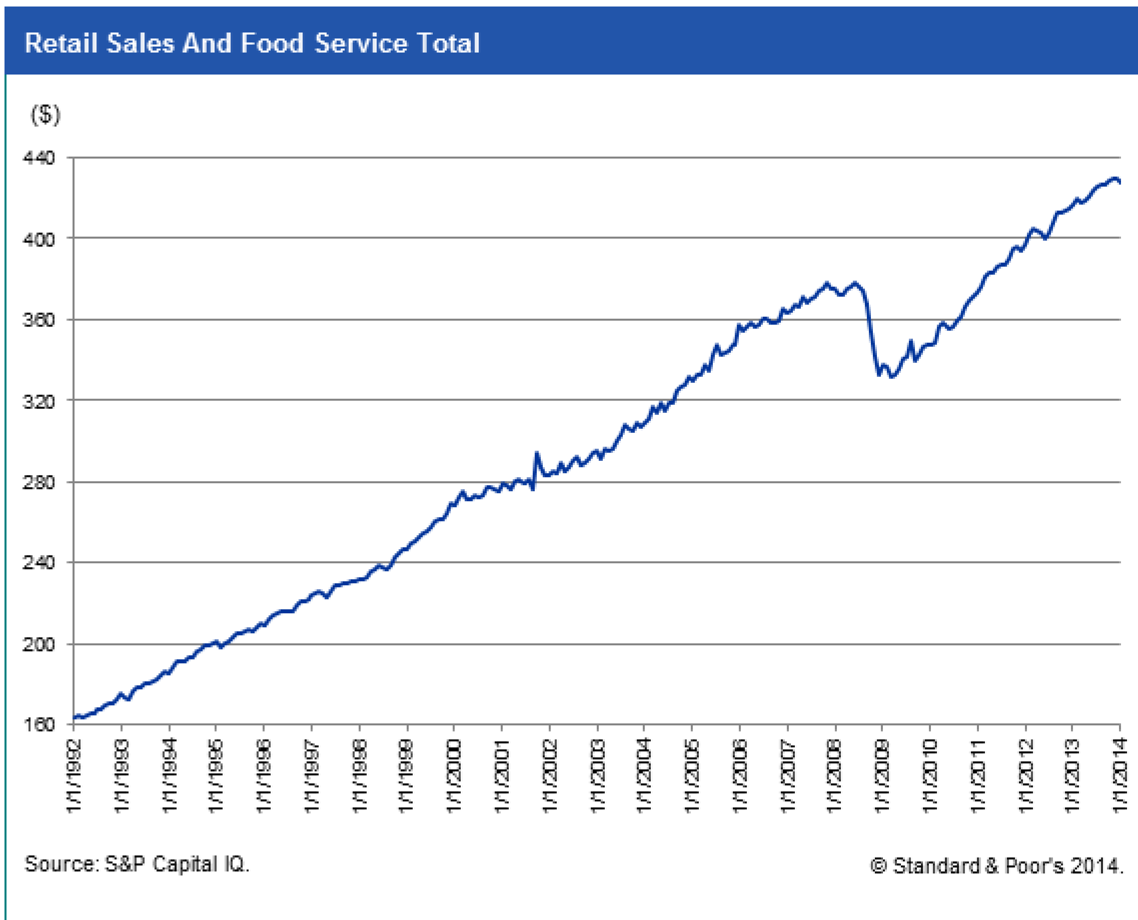
Chart 2



Inside This Issue:

Macroeconomic Overview

Severe winter weather has been a significant but largely unquantifiable negative influence on the U.S. economy since the start of 2014, and investors have been content to largely look past weaker than expected weather-influenced economic data. Like many market participants, GMI Research anticipates healthier data once the U.S. begins its winter thaw, but judging by existing market valuations, we are also mindful that investors may not be very forgiving of sustained disappointing data after we enter the second quarter of this year.

Economic And Market Outlook: North American And European Earnings

The consumer staples sector is the worst-performing sector in terms of revenue performance, with nearly 70% of its companies missing S&P Capital IQ consensus estimates. The personal products and tobacco subsectors, with every company within those industries missing revenue expectations, were largely to blame. The two companies within personal products, Estee Lauder Companies Inc. and Avon Products Inc., blamed losses on softness in European sales and slowing growth in China.

International Update: Emphasis Is On Spanish Over Greek, Irish, And Portuguese Stock Exposures For Foreseeable Future

Economic consensus projections are for macroeconomic trends of the eurozone periphery to improve further in 2013 and 2014 provided, of course, that the core members of the euro-18 continue to expand as well. Ireland and Spain appear to be in the best position to expand. Expansion projections for this year and next year of 1.9% and 2.3% for Ireland and 0.8% and 1.3% for Spain seem ambitious, but--in the expectations of many analysts--are attainable. By contrast, Greece and Portugal will struggle to post positive real GDP gains: economic consensus forecasts are for Greek real activity to reach 0% this year and advance 1.4% in 2014, while Portugal should eke out a 0.5% rise and accelerate to 1.1% in 2013 and 2014, respectively.

S&P Dow Jones Index Commentary: An Initial Look At The State Of The Union (500 That Is)

The earnings story for the fourth quarter remains the same--slow earnings growth, slower sales growth, and a high number of companies beating estimates. However, it's important to note that in each quarter of 2013, earnings set new records, and current estimates indicate more earnings records in 2014. Earnings, boosted by higher margins, are supporting the market, but revenue growth remains weak.

Leveraged Commentary And Data: Loan Repayment Rate In S&P/LSTA Index Hit Eight-Year High In 2013

Last year's reading lifted the historical average annual repayment rate of Index loans to 37.3%, from 36.7% during the 1998 to 2012 time period. That implies that the portfolio of Index loans turns over every 15.6 months, on average. That said, issuers tend to stay in the leveraged loan universe much longer than the figure suggests. In fact, issuers that entered the Index prior to 2010 remained there for 4.8 years, on average.

R2P Corporate Bond Monitor

U.S. payroll data released on Feb. 7 rose less than projected in January, but the jobless rate unexpectedly dropped to the lowest level in more than five years, clouding the outlook for the U.S. economy and Federal Reserve. The 113,000 point gain in hiring fell short of the 180,000 point level that economists forecasted, according to the Labor Department. Further, unemployment declined to 6.6% (from 6.7% in December), the lowest mark since October 2008. Likewise, the Federal Reserve's industrial production report, released on Feb. 14, revealed a decline of 0.3% in January, including a 0.8% drop in manufacturing output, following a rise of 0.3% in December. The Fed, which decreased its monthly bond purchases to $65 billion at the last FOMC meeting, blamed the weather for the January figure.

Market Derived Signal Commentary: A Muted Reaction To Negative Housing News

On Tuesday, the National Association of Home Builders (NAHB)/Wells Fargo Index, which measures sentiment, dropped to 46 in February from 56 in January, indicating that more builders reported negative rather than positive market conditions. Within the index, confidence in current single-family sales declined to a score of 51 from 62, while the outlook for single-family sales over the next six months fell to 54 from 60, according to figures from the NAHB. Prospective buyer foot traffic retreated to 31 from 40, with the NAHB citing bad weather. "Builders also have additional concerns about meeting ongoing and future demand due to a shortage of lots and labor," the group said in a statement.

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

With regard to deal size, IPO performance this year has been mixed. As indicated below, of the 12 issues raising $100 million or more in their IPOs, the average price gain from the offer price was 18.4%. At the other end of the spectrum, the

six issues raising $50 million or less in their IPOs have seen an average price change of -0.5% from their debut price. Additionally, among the top 10 IPOs priced this year, only two are currently trading below their offer price. Conversely, of the 10 smallest IPOs completed this year in the U.S. market, five are trading underwater. To this end, a general rule for IPOs this year is that size matters for performance.

Economic And Market Outlook: North American And European Earnings

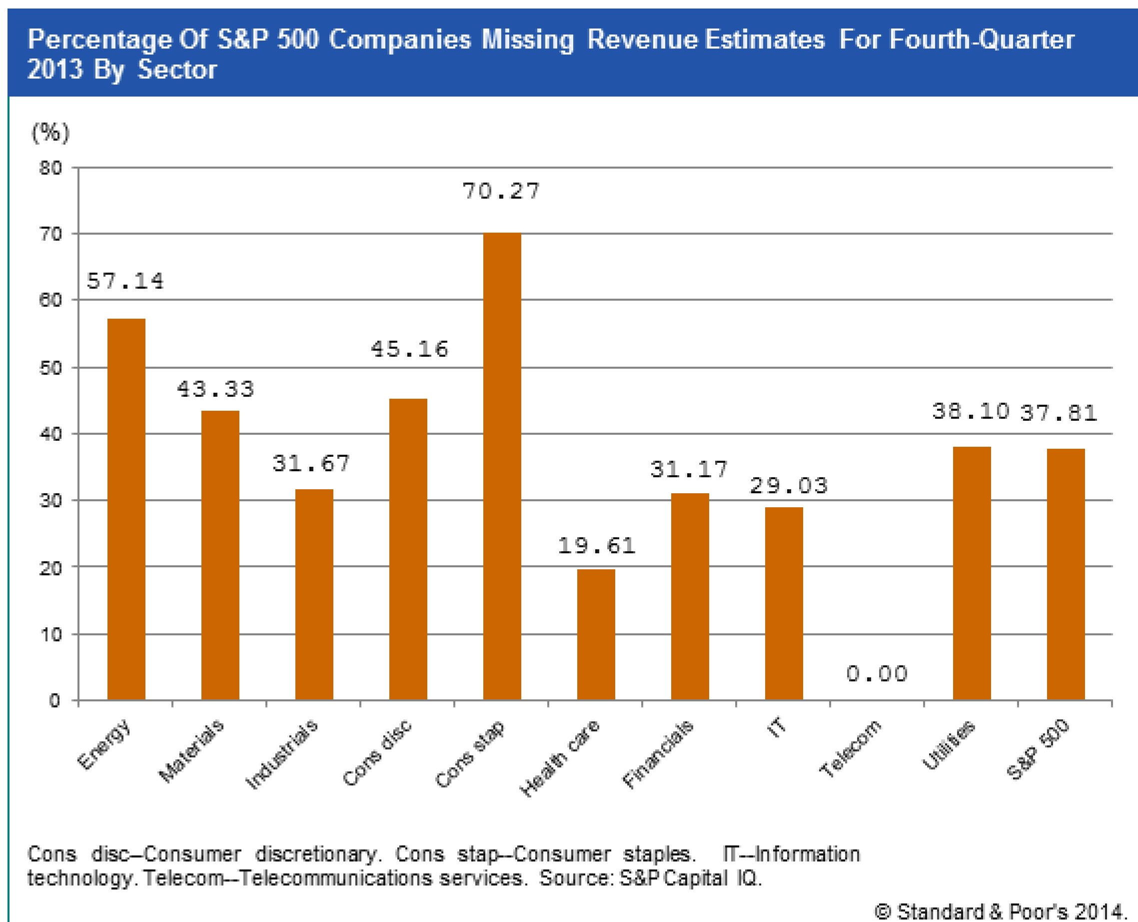
North America

This week, we have seen fourth-quarter earnings growth for the S&P 500 increase to 7.9%, which is near the 8% to 9% range Global Markets Intelligence predicted at the beginning of the season. With 60 companies left to report, we believe earnings growth will top 8% by the time the season is completed, making this the strongest quarter for profit growth since fourth-quarter 2011. However, while earnings results have been blowing past analysts' expectations, results on the top line have failed to impress.

After several quarters of weak revenue growth figures, ranging from the low-single digits to the negative growth seen during second-quarter 2013, we believed third-quarter 2013 would be an inflection point for corporate sales. During the third quarter, top-line growth came in at 4.1%, the strongest showing since second-quarter 2012. At that time, analysts expected this relatively strong growth to continue into the final quarter of the year. However, after hitting a peak of 3.6% a few weeks ago, revenue growth is once again lower than analysts' expectations of 2.8%.

The consumer staples sector is the worst-performing sector in terms of revenue performance, with nearly 70% of its companies missing S&P Capital IQ consensus estimates. The personal products and tobacco subsectors, with every company within those industries missing revenue expectations, were largely to blame. The two companies within personal products, Estee Lauder Companies Inc. and Avon Products Inc., blamed losses on softness in European sales and slowing growth in China.

Chart 3

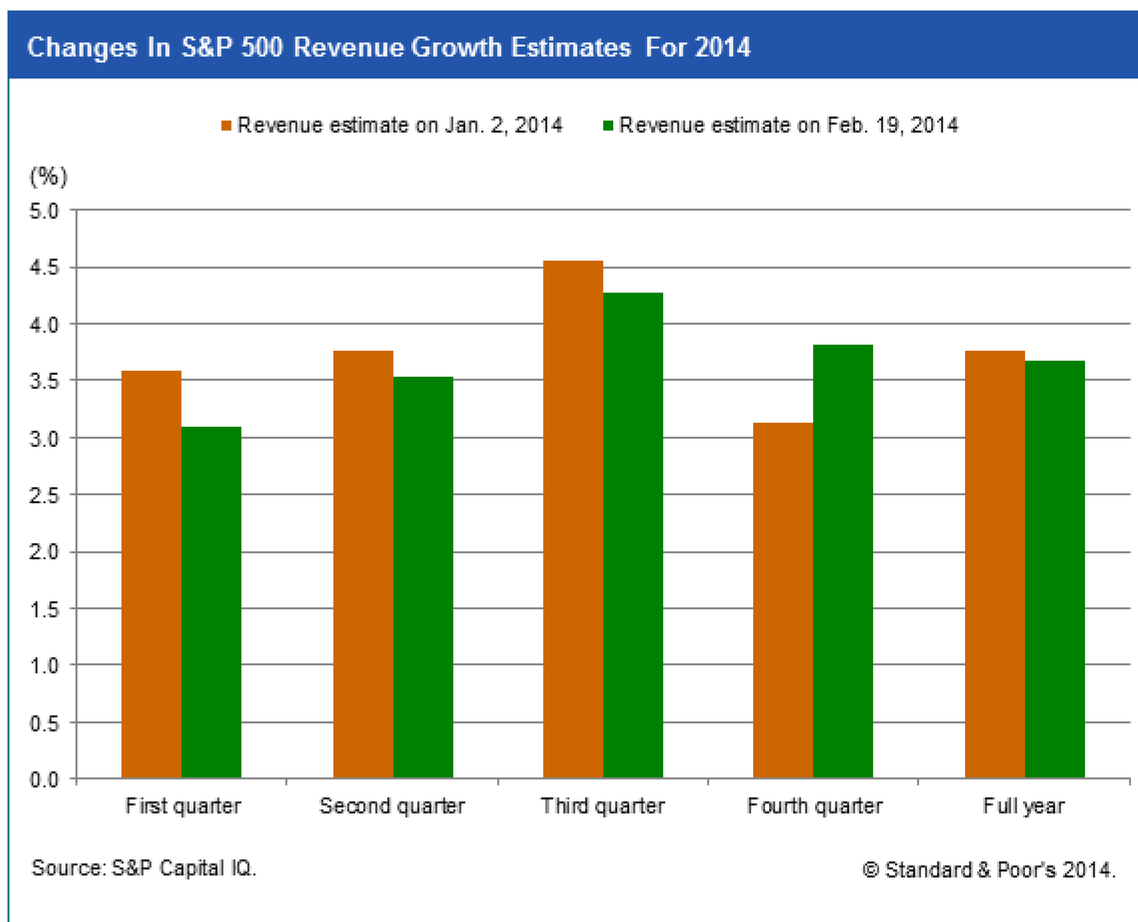


In the energy sector, nearly 57% of companies missed revenue expectations for the fourth quarter. Of the 24 companies that have reported from the oil, gas, and consumable fuels subsector, 18 have missed revenue estimates, including Exxon Mobil Corp. (second-largest market cap in the S&P 500 index), Valero Energy Corp., ConocoPhillips Co., and Chevron Corp. Further, 15 of those companies also reported lower year-over-year revenue growth, in addition to missing estimates. Many of these companies blamed narrower refining margins, weak demand out of China, overall higher operating expenses, and lower production volume.

The health care sector is the only sector to impress on the top line. Over 80% of companies from the sector beat revenue expectations, and at 7% revenue growth, it has the second-largest revenue growth behind the consumer discretionary sector (13.3%). Strength was seen in nearly every health caresubsector, particularly within the heavily weighted biotechnology and pharmaceuticals industries.

Looking ahead, analysts have lowered their 2014 revenues estimates for each quarter except the fourth quarter, bringing the overall growth estimate to 3.7% from 3.8%, pressured by the industrials and consumer discretionary sectors. Analysts expect the energy, health care, and telecommunication services sectors to report revenue growth for the year.

Chart 4



In 2014, the focus on corporate revenue growth will be greater than ever. Now that U.S. companies have proven that they can post impressive earnings growth, comparable to long-term historical averages, the true test of corporate health will be determined by the ability to grow sales. Cost cutting will no longer appease. The U.s. economy is looking for solid revenue to growth, the indicator of business growth, to support improvement in GDP and unemployment figures.

Europe

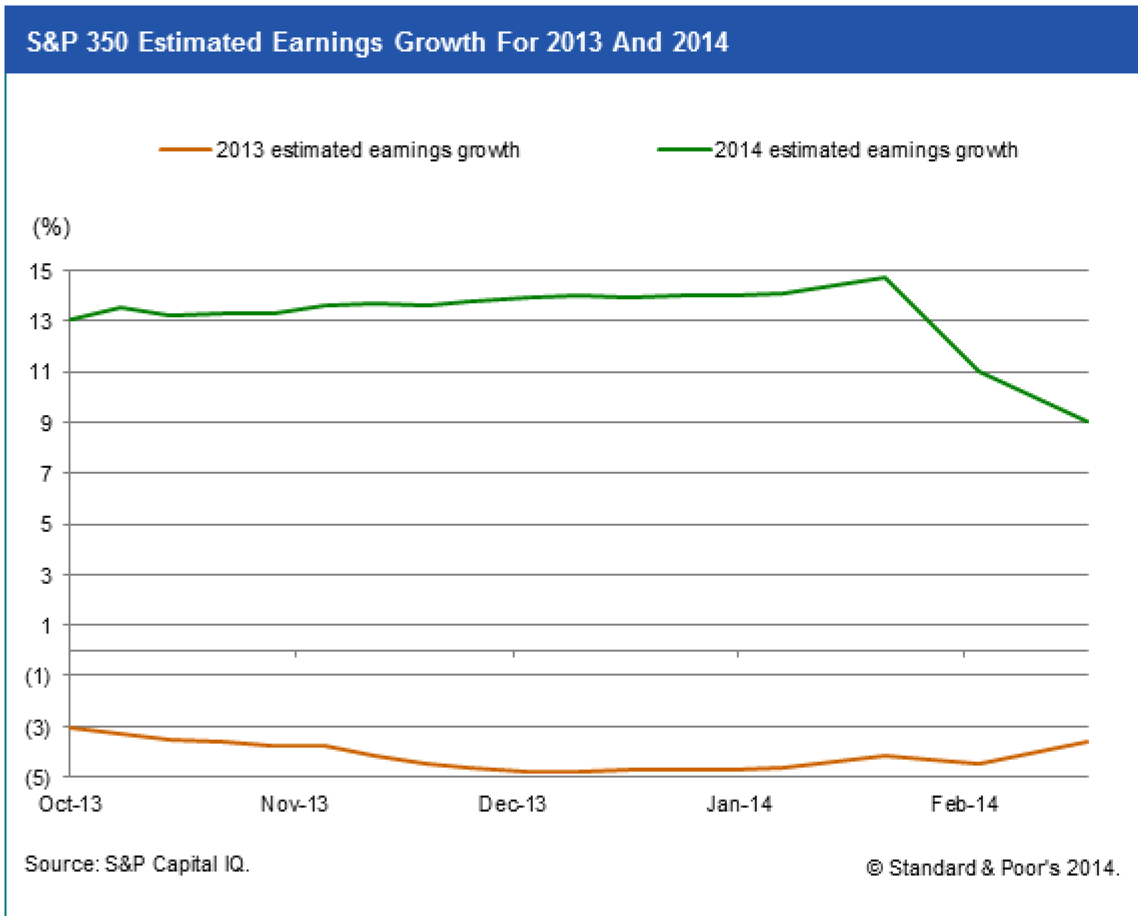
Fourth-quarter earnings season remains at its peak for the S&P Europe 350, with seven companies reporting for the quarter and an additional 24 companies reporting for 2013. Of this group, four have missed earnings expectations, two have met earnings expectations, and only one has beaten forecasts. Sex companies missed sales estimates and one beat sales estimates. This is in-line with the disappointing revenue trend we are seeing in the S&P 500.

Overall fourth-quarter earnings growth now stands at 0.5%. Sixty-three of the 184 companies that have estimates and are scheduled to release results have thus far reported. Not all 350 companies will report for the fourth quarter as the FSA does not require them to file quarterly. Analysts anticipate the information technology (154%) and financials (47%) sectors to lead profit growth in the fourth quarter

Six sectors are expected to post negative results for the quarter: energy (-26.8%), materials (-32.1%), consumer discretionary (-2.5%), health care (-0.3%), and telecommunication services (-42.6%).

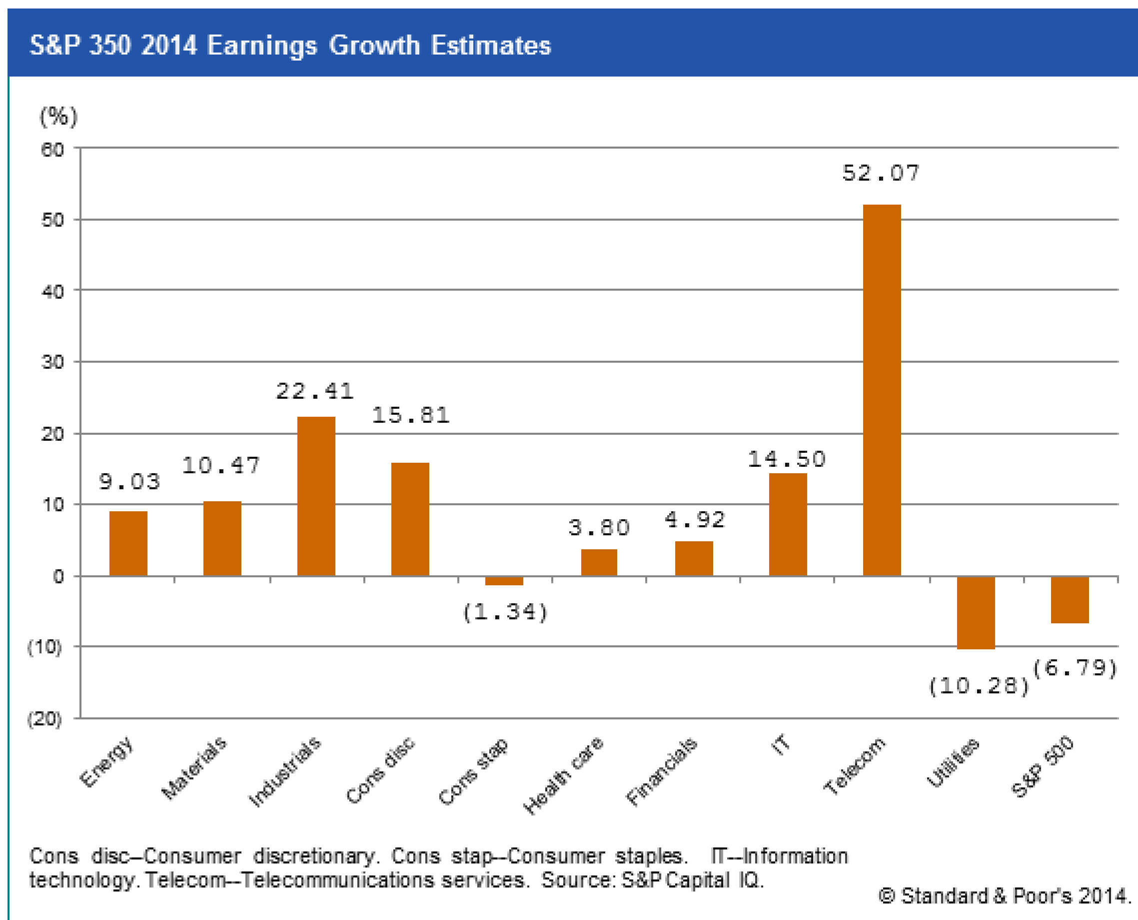
Analysts currently anticipate negative growth of 3.6% for the calendar year for the first time since 2011. The utilities and energy sectors, with -23.3% and -14.9% growth estimates, respectively, will be the biggest laggards, according to analysts' expectations. Of the 24 companies that reported yearly results this week, 15 missed earnings estimates, while nine beat them. On the revenue front, 19 companies missed and five beat sales expectations.

Chart 5



Due to the number of disappointing results over the last couple of weeks, analysts have ratcheted down their overall calendar-year 2014 estimates to 9.0% from 11% on Feb 7. Still, if the S&P 350 reaches this level, it will be the highest profit growth for the index since 2010 (42.5%). The sectors that analysts expect to report negative growth are the telecommunication services (-10.3%), utilities (-6.8%), and consumer discretionary (-1.3%) sectors, while analysts estimate that five sectors (energy, materials, industrials, financials, and IT) will post double-digit growth for the year.

Chart 6



Peak fourth-quarter earnings season for the S&P 350 will continue next week, with 14 companies scheduled to report for the quarter and 37 companies expected to report full-year results.

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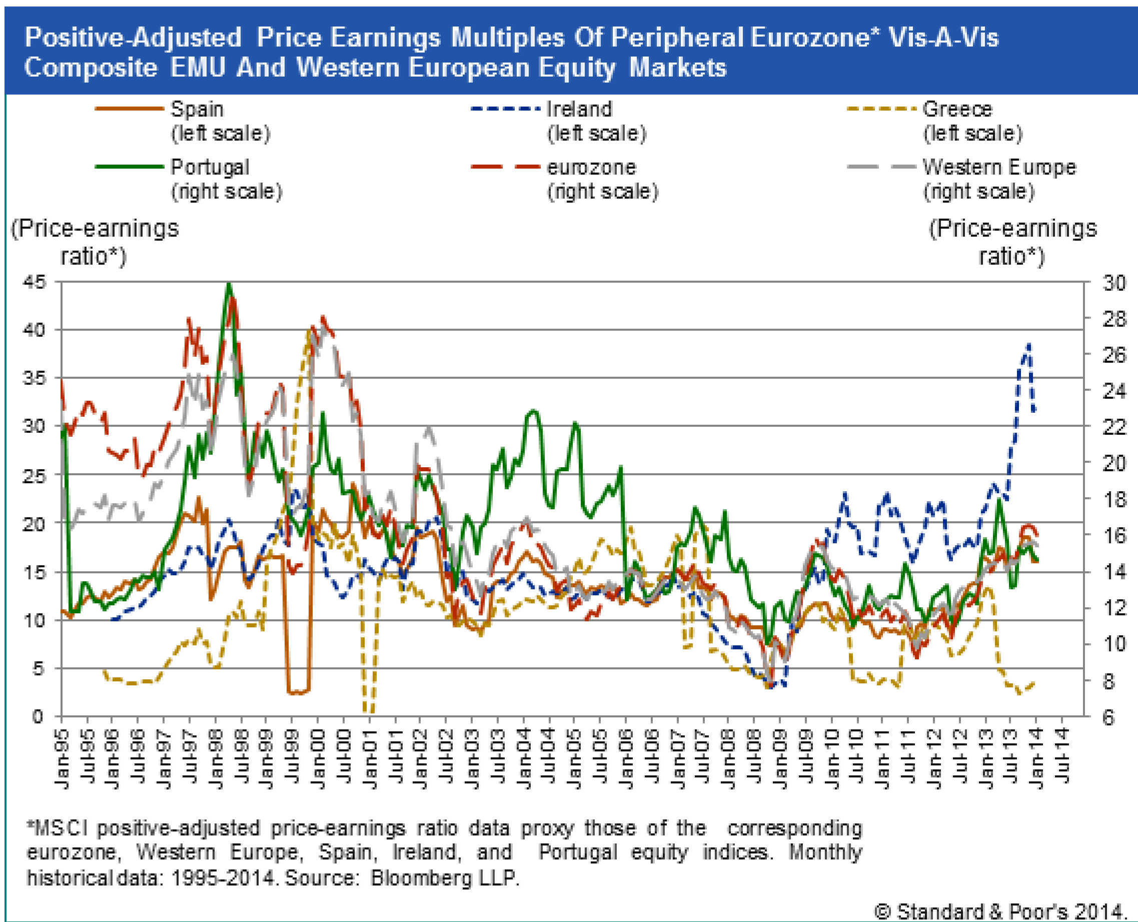
International Update: Emphasis Is On Spanish Over Greek, Irish, And Portuguese Stock Exposures For Foreseeable Future

The relatively positive performance of the peripheral stock markets of the European Monetary Union (EMU) so far this year would seem to be a favorable development for the eurozone as a whole. Fiscal consolidation should proceed to rein in spending excesses and reinforce budgetary rectitude; inflation will likely remain fractionally positive in Portugal, Ireland, and Spain, but marginally negative in Greece; and analysts expect external accounts to return to surplus before 2014. In return for much-needed progress on the economic and fiscal fronts, capital markets have rewarded the outstanding debt of all four countries with top 10 rankings since January 2013. Moreover, the Portuguese, Irish, and Greek shares markets have ranked among the top 20 performers, with Spain having placed among the top 30 during the same time frame. Nevertheless, tenuous economic gains and precarious political regimes are encouraging the political leadership in all four peripheral eurozone nations to distance themselves gradually from the financial adjustment programs that have brought them much success in restoring a measure of probity to their public finances.

Chart 7



Economic consensus projections are for macroeconomic trends of the eurozone periphery to improve further in 2013 and 2014 provided, of course, that the core members of the euro-18 continue to expand as well. Ireland and Spain appear to be in the best position to expand. Expansion projections for this year and next year of 1.9% and 2.3% for Ireland and 0.8% and 1.3% for Spain seem ambitious, but--in the expectations of many analysts--are attainable. By contrast, Greece and Portugal will struggle to post positive real GDP gains: economic consensus forecasts are for Greek real activity to reach 0% this year and advance 1.4% in 2014, while Portugal should eke out a 0.5% rise and accelerate to 1.1% in 2013 and 2014, respectively. Still, the persistence of double-digit joblessness will restrain inflation-adjusted aggregate economic growth from making further upward progress by depressing domestic demand. So, irrespective of any advancement foreseen for real macroeconomic growth in the EMU periphery, only an improvement in job market prospects will guide internal demand and, ultimately, the overall economy higher.

Political fragility should remain a potentially disruptive source of tension for the fiscal policymaking environment in most of the peripheral eurozone economies. The likelihood of political fragmentation is most dire in Greece, where the current ruling coalition is coming under intense pressure to schedule national elections before year end. Radical left-wing Greek parties pose a direct threat to the present regime's commitment to adhere to the budgetary targets of its European Union and IMF creditors. In Lisbon, meanwhile, the governing alliance may have survived numerous resignations thanks to its retention of a solid majority in the legislature. However, a resurfacing of political tensions in the coalition could prompt the regime to dissolve parliament and hold earlier-than-expected elections. Ireland, too, is susceptible to near-term political instability--especially in light of the ruling Fine Gael-Labor coalition's low popularity, evident in recent public opinion

polls ahead of this May's local and European Parliament balloting. Of the four countries, only Spain's center-right government seems stable after having secured a firm majority in the 2011 general election and victories in 13 provincial legislatures.

From a relative valuation standpoint, Spain's IBEX 35 is trading at a discount to its peers in the EMU periphery. Its positive-adjusted 2014 forward price-earnings multiple (p-e) of 14.7x is firmly below those of Portugal's PSI 20 (19.4x), Greece's Athex Composite (16.6x), and Ireland's Overall (24.5x). Although IBEX's 2014 forward p-e is higher than its historical average (13.5x) and well above its all-time low (2.4x), it is 9.4 points under its record high of 24.1x. Also, in spite of the fact that the IBEX's 2014 forward p-e trades at a premium to the U.K.'s shares market, euro-land's core stock exchanges, and regional indices, its downward trajectory through 2016 renders it comparatively attractive across Western Europe.

In conclusion, the case for market-weighting, or perhaps slightly over-weighting, the Spanish equities market appears comparatively more compelling than arguments for doing so for their rivals in the euro-18 periphery--namely Portugal, Ireland, and Greece--regardless of the latter's year-to-date outperformance of the IBEX 35. Neither Greece, Portugal, nor Ireland convincingly offers much in the way of upside economic potential and long-term political stability to justify anything more than under-emphases of their respective stock exchanges in the immediate future. Furthermore, few prospects exist for a recovery in the Greek, Portuguese, and Irish labor markets, which will continue to inhibit growth in personal consumption and, consequently, the real economy. Alternatively, Spain's potential, both economically and politically, seems relatively greater than that of its three competitors in the EMU's periphery, qualifying it for a slight over, or even market-weighting contingent on the risk preferences of investors who should tread cautiously on investments in the banking and housing sectors.

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S&P Dow Jones Index Commentary: An Initial Look At The State Of The Union (500 That Is)

With 90% of fourth-quarter earnings reported, SEC documents and dividend increases are starting to pour in (February is the busiest time for dividend increases). While the retail sector, whose margins have been pressured by intense promotional activity, has yet to report, we were still able to gauge some overall metrics for the fourth quarter and year.

In 2013, the takeaway was the market, as measured by the S&P 500, which gained 29.60% (32.39% with dividends). From the 2013 close (1,848.36) and the Jan. 15 all-time closing high (1,848.38), the market had declined by 1.06% (0.78% with dividends) as of Feb. 19.

The earnings story for the fourth quarter remains the same--slow earnings growth, slower sales growth, and a high number of companies beating estimates. However, it's important to note that in each quarter of 2013, earnings set new records, and current estimates indicate more earnings records in 2014. Earnings, boosted by higher margins, are supporting the market, but revenue growth remains weak.

Actual dividend payments were a record for the fourth quarter and for 2013. Analysts expect first-quarter payments, which are typically lower than those in the fourth quarter, to increase 12% from the first quarter of 2013. Further, analysts estimate that payments for all of 2014 should easily beat the record, potentially by double-digits. Nevertheless, companies are only returning 36% to shareholders versus the historical rate of 52% since 1936.

Buybacks have been the rage, but companies are going to have to spend 30% more to buy back the same number of shares in 2014 as they did in 2013 (since prices have gone up). The share count is more relevant to EPS, and on that count, we are seeing a greater number of companies reducing their share counts, which is providing a tailwind to earnings. Apple

Inc., which holds the quarterly record of $16 billion in buybacks posted in the second quarter of 2013, already purchased $14 billion in the first two weeks of January.

As far as capital expenditures, the good news is that spending appears to be higher, which is usually the case for the fourth quarter, led by oil and gas companies in the energy sector and AT&T Inc. and Verizon Communications Inc. in the telecommunications services sector. There are some indications of expansion, although these are not necessarily as domestically focused as we would hope.

It also appears that companies may have closed 2013 with more money than ever, potentially posting their sixth consecutive quarter of record cash. Regardless of a new cash record, the level represents 91 weeks of net income (based on the last 12 months declared), which is enough for companies to do whatever they want.

Table 1

S&P Dow Jones Indices

Period	Market value (bil. $)	Operating earnings (bil. $)	As reported earnings (bil. $)	Dividends (bil. $)	Buybacks (bil. $)	Capex (bil. $)	Dividend yield (%)	Buyback yield (%)	Dividend and buyback yield (%)
12/31/2013	16,494.78	**254.33**	**244.79**	84.98	**129.39**	**163.09**	1.89	**2.88**	**4.77**
9/30/2013	14,960.48	239.50	219.13	79.26	128.16	148.07	2.05	2.98	5.03
6/30/2013	14,309.96	234.84	221.56	76.67	118.05	144.79	2.07	2.94	5.02
3/31/2013	13,978.82	229.57	215.76	70.86	99.97	128.00	2.06	2.97	5.02
12/31/2012	12,742.44	206.84	184.50	79.83	99.15	156.28	2.20	3.13	5.33
9/30/2012	12,881.02	214.58	189.64	69.48	103.72	145.04	2.07	3.01	5.08
6/30/2012	12,303.11	225.53	195.27	67.31	111.75	141.67	2.08	3.27	5.35
3/31/2012	12,730.25	219.09	208.15	64.07	84.29	129.52	1.95	3.14	5.09
12/31/2011	11,385.01	214.83	186.85	65.89	87.59	145.02	2.11	3.56	5.67
09/30/2011	10,303.14	230.30	206.08	59.20	118.41	137.24	2.22	3.92	6.14
6/30/2011	12,021.16	226.29	202.44	59.03	109.24	130.78	1.84	3.04	4.88
3/31/2011	12,067.74	205.34	195.15	56.08	89.84	112.67	1.76	2.76	4.52
12/31/2010	11,429.83	199.40	187.67	54.85	86.36	145.31	1.80	2.61	4.42
09/30/2010	10,336.29	195.28	176.80	51.26	79.56	113.16	1.94	2.52	4.45
06/30/2010	9,322.58	189.04	178.00	50.44	77.64	101.67	2.10	2.31	4.41
03/31/2010	10,560.00	175.00	157.85	49.28	55.26	84.66	1.83	1.54	3.36
12/31/2009	9,927.54	152.77	135.14	49.04	47.82	118.41	1.97	1.39	3.36
09/30/2009	9,336.51	139.37	130.37	47.21	34.85	92.39	2.24	1.48	3.71

Note: S&P 500 estimates in bold. Source: S&P Capital IQ.

Table 2

S&P Dow Jones Indices S&P Industrials (Old) Cash And Equivalent Levels*

Period	Cash and equivalent (mil. $)	Market value (%)
12/31/2013	**1,292,008**	**9.97**
9/30/2013	1,245,790	10.59
6/30/2013	1,143,837	9.60
3/31/2013	1,093,516	9.35
12/31/2012	1,091,310	10.08
9/30/2012	1,030,442	9.39
6/30/2012	985,375	9.49

Table 2

S&P Dow Jones Indices S&P Industrials (Old) Cash And Equivalent Levels* (cont.)		
3/31/2012	1,013,187	9.36
12/31/2011	1,027,296	10.69
9/30/2011	998,581	11.48
6/30/2011	976,061	10.23
3/31/2011	963,314	9.68
12/31/2010	940,149	10.46
09/30/2010	902,389	9.85
06/30/2010	842,494	11.59
03/31/2010	836,771	10.14
12/31/2009	831,188	9.99
9/30/2009	820,287	10.70

*Cash and equivalents (cash) are classified under current assets on the balance sheet and represent the readily available discretionary liquid assets of a company. Cash is measured for the S&P Industrials (Old), which consist of the S&P 500 minus financials, utilities, and transportation issues since these issues maintain high cash reserves as part of their normal operating process. Note: The S&P Industrials (Old) date back for decades. When the GICS classifications were developed, one of the new sectors was the industrials, so the former group is referred to as the S&P industrials (Old). Source: S&P Capital IQ.

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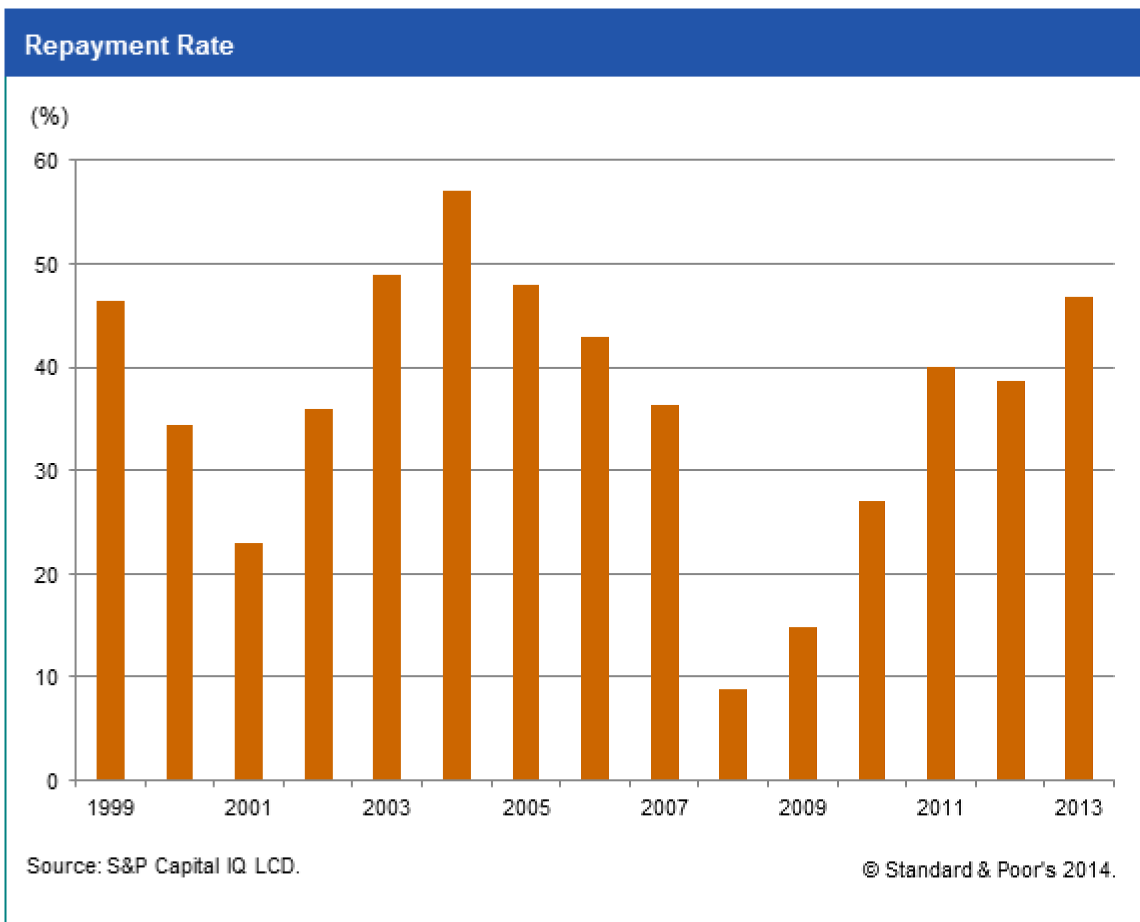
Leveraged Commentary And Data: Loan Repayment Rate In S&P/LSTA Index Hit Eight-Year High In 2013

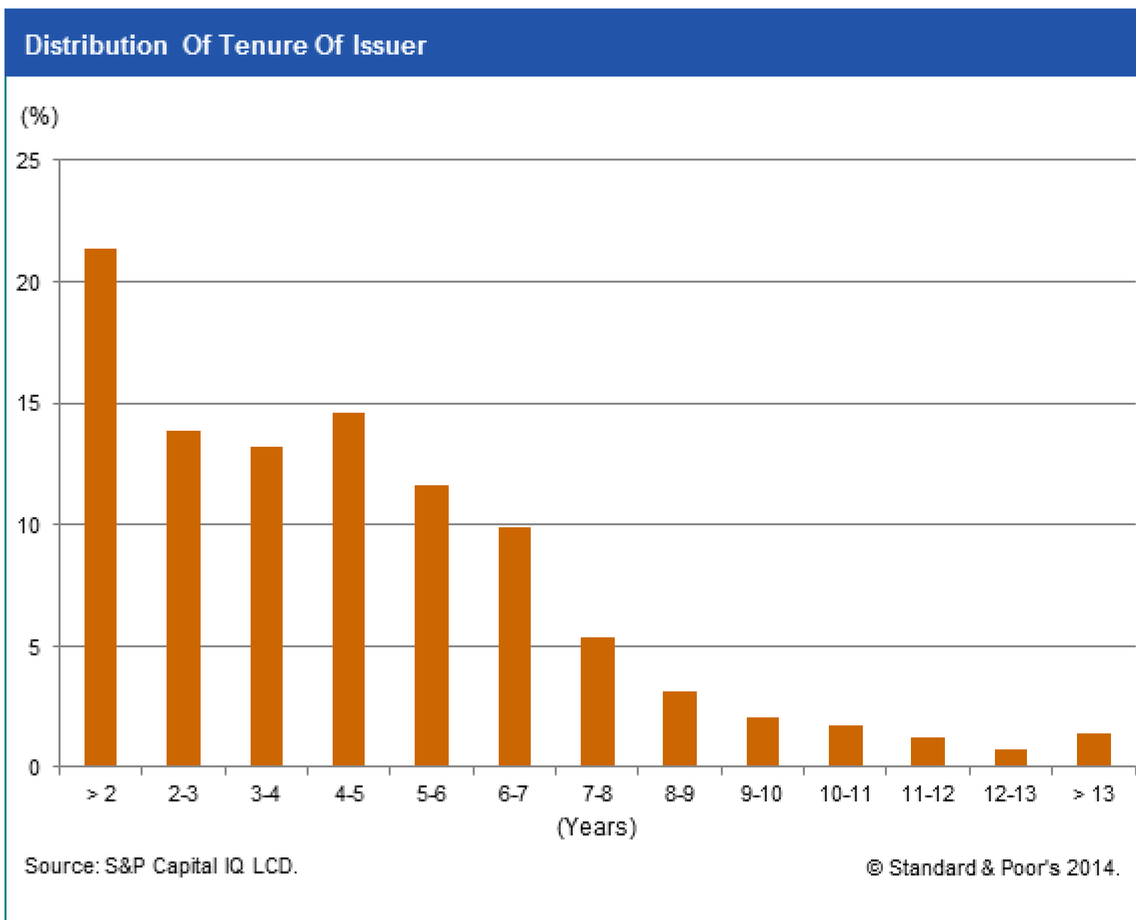
The repayment rate in the S&P/LSTA Leveraged Loan Index surged to an eight-year high of 47% in 2013, from 39% in 2012, as red-hot conditions enabled issuers to replace loans via refinancings, recaps, repricings, bond takeouts, and merger and acquisition (M&A)-related executions.

Chart 8



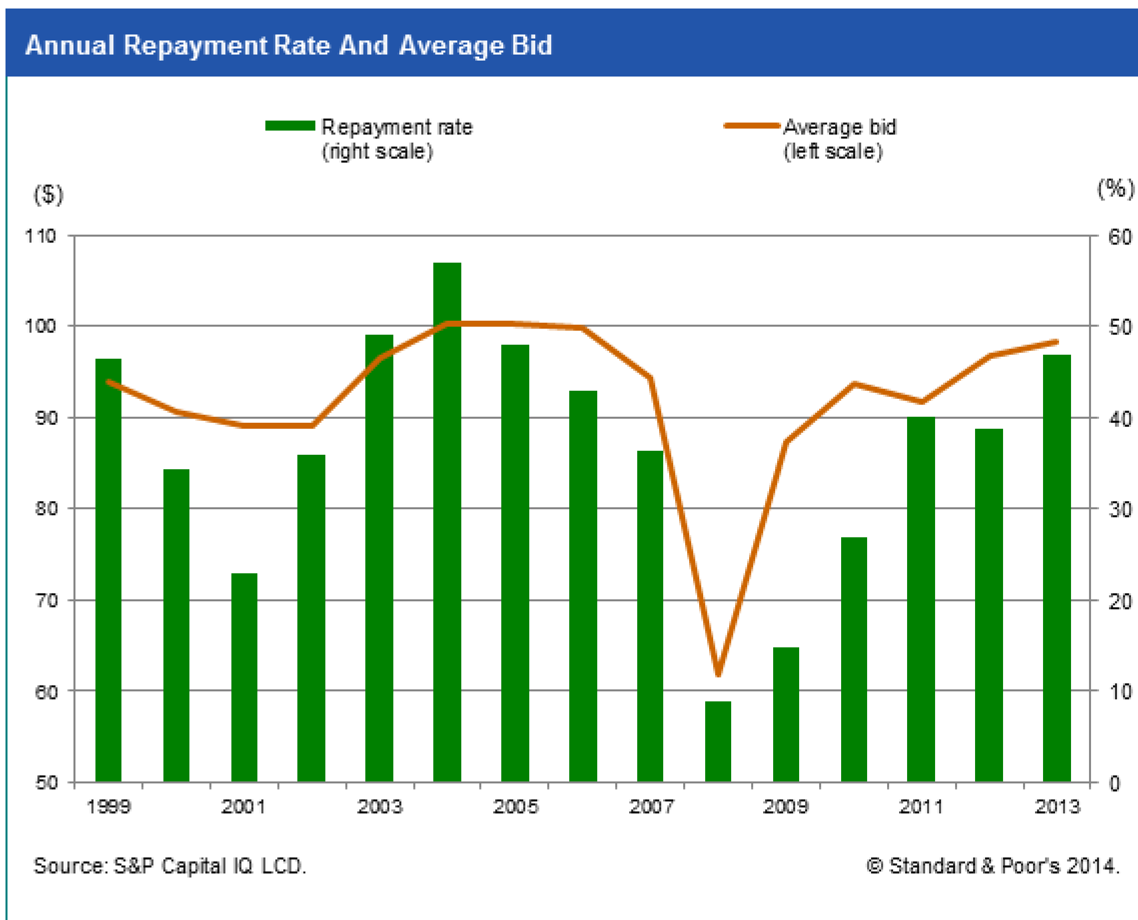
Last year's reading lifted the historical average annual repayment rate of Index loans to 37.3%, from 36.7% during the 1998 to 2012 time period. That implies that the portfolio of Index loans turns over every 15.6 months, on average. That said, issuers tend to stay in the leveraged loan universe much longer than the figure suggests. In fact, issuers that entered the Index prior to 2010 remained there for 4.8 years, on average.

Chart 9



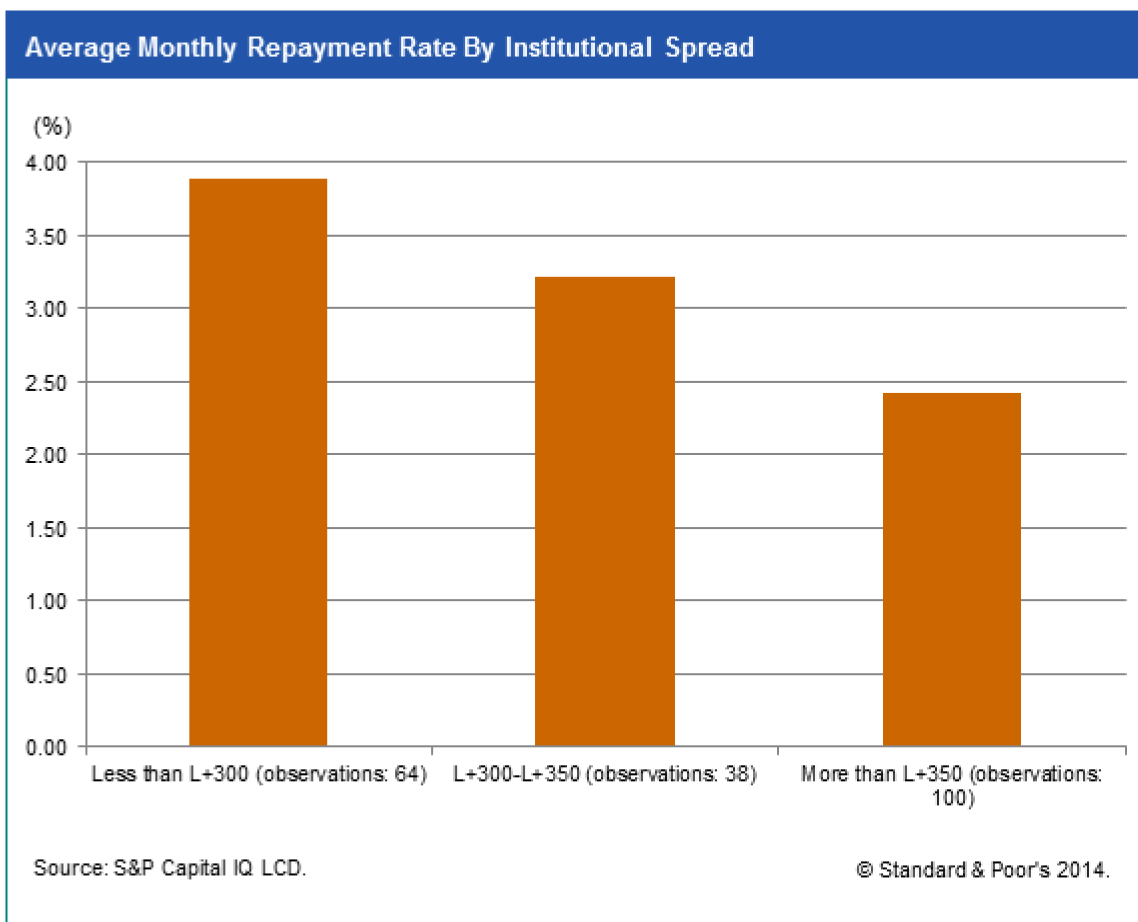
Because loans are prepayable, however, borrowers rejigger loans fairly often, giving managers a chance to exit. Just how often depends, naturally, on market conditions. For instance, in years that the average bid price of Index loans exceeded $95, the repayment rate averaged 47.2%, versus 36.8% when the average bid ranged from $90 to $95, and 20.6% when the bid was south of $90. However, it's not for nothing that the highest repayment year--2004, when the rate hit 57%--was also the year when the average bid reached its zenith of $100.30. Further, it was not a coincidence that 2008 had both the lowest repayment rate (8.8%) and lowest average bid ($61.7).

Chart 10



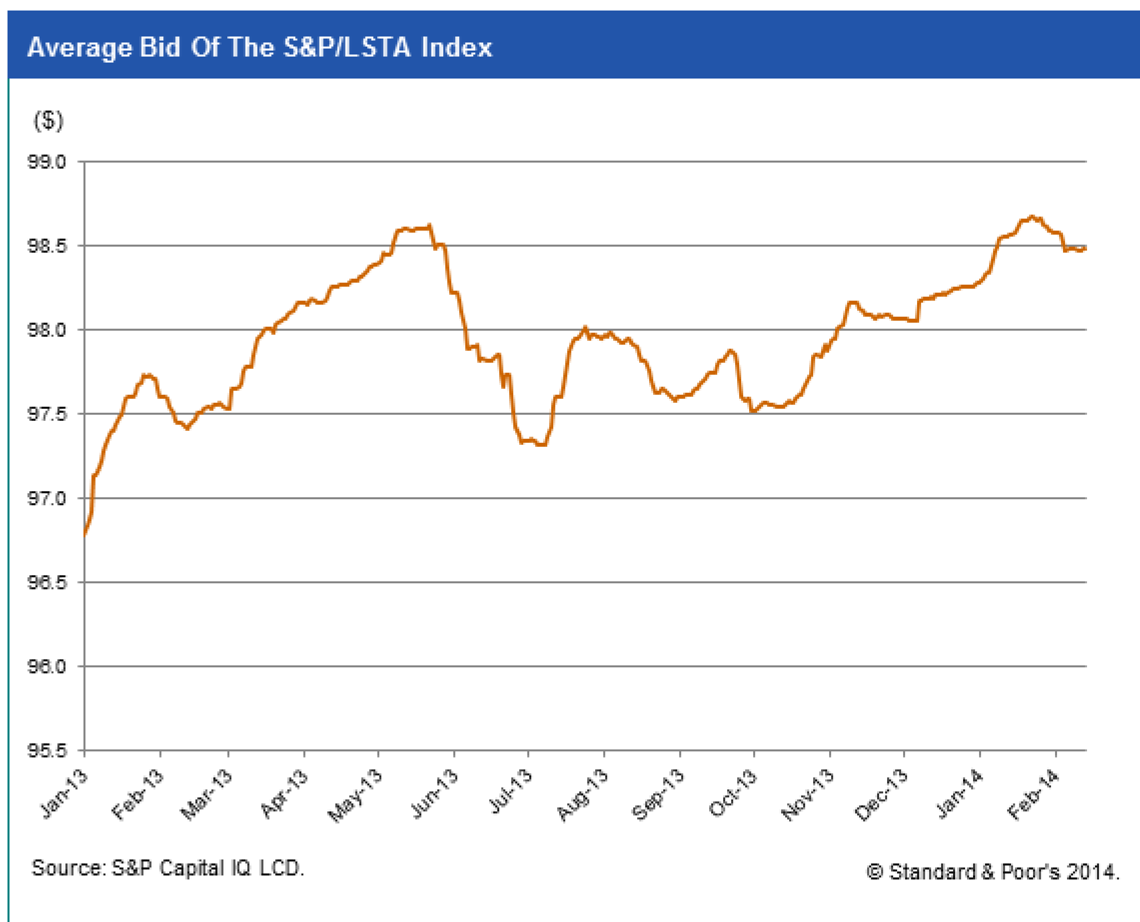
Another way to view the data is that when spreads are narrow, the repayment rate jumps, as Chart 11 illustrates:

Chart 11



The data imply that 2014 will be another year of rapid-fire repayments. After all, on Feb. 13, the average bid of Index loans stood near the post-credit-crunch high of $98.48.

Chart 12



For this reason, in part, the repayment rate of Index loans in 2014 stands at 4.42% (as of Feb. 14), just inside the year-over-year comparable mark of 4.58%. Of course, the rate could slow quickly if market conditions deteriorate, thereby narrowing the options available to issuers looking to replace loans with more efficient financing.

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R2P Corporate Bond Monitor

North America

U.S. payroll data released on Feb. 7 rose less than projected in January, but the jobless rate unexpectedly dropped to the lowest level in more than five years, clouding the outlook for the U.S. economy and Federal Reserve. The 113,000 point gain in hiring fell short of the 180,000 point level that economists forecasted, according to the Labor Department. Further, unemployment declined to 6.6% (from 6.7% in December), the lowest mark since October 2008. Likewise, the Federal Reserve's industrial production report, released on Feb. 14, revealed a decline of 0.3% in January, including a 0.8% drop in manufacturing output, following a rise of 0.3% in December. The Fed, which decreased its monthly bond purchases to $65 billion at the last FOMC meeting, blamed the weather for the January figure.

Europe

The eurozone's economy has enjoyed a strong start to the year, according to Markit's Purchasing Managers' Index (PMI), which incorporates most aspects of the economy, including manufacturing. In January, the PMI grew at its fastest rate since June 2011 to 52.9 from 52.1 in December (figures above 50 indicate economic growth). Germany, the bloc's largest economy, drove the expansion, with a composite score of 55.5--its highest level in more than two and a half years. However, data from Eurostat showed that December retail sales data declined 1.6% from November and 1% from the comparable period a year ago, suggesting that the eurozone recovery is still fragile. Germany and Spain, with retail sales down 2.5% and 3.6%, respectively, on the month, pressured results.

Credit Markets

Against this backdrop, yields decreased across the board month-to-date through Feb. 13, while credit and market risks were fairly unchanged, indicating deteriorating risk-reward profiles, as measured by average Risk-to-Price (R2P) scores (see tables 3 and 4).

In North America, scores decreased by 4% as a result of a tightening in the average option-adjusted spread (OAS) of 6 basis points (bps). The average probability of default (PD) remained unchanged, and the historical 20-day bond price volatility (BP Vol.) decreased by 0.01%.

In Europe, scores decreased by 10% as a result of a tightening in the average OAS of 10 bps. In addition, the average PD and BP Vol. slightly deteriorated, increasing by 0.01% and 0.002%, respectively.

Table 3

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

	Scores (%)	OAS (bps)	PD (%)	BP Vol. (%)
Consumer discretionary	(9)	(15)	(0.011)	0.080
Consumer staples	(11)	(10)	0.056	(0.026)
Energy	(2)	(6)	(0.029)	(0.035)
Financials	(9)	(7)	0.004	(0.023)
Health care	(3)	(5)	(0.005)	(0.035)
Industrials	(10)	(4)	0.010	0.009
Information technology	(3)	1	0.010	(0.024)
Materials	(5)	(15)	(0.026)	0.023
Telecommunication services	1	1	0.002	(0.030)
Utilities	13	(6)	(0.008)	(0.038)
Average	**(4)**	**(6)**	**0.000**	**(0.010)**

One month change to Feb. 13, 2014. Source: S&P Capital IQ.

Table 4

Europe Risk-Reward Profiles By Sector--One Month Average R2P Score And Components Changes

	Scores (%)	OAS (bps)	PD (%)	BP Vol. (%)
Consumer discretionary	(12)	(9)	(0.007)	0.010
Consumer staples	(2)	(7)	(0.003)	(0.023)
Energy	(10)	(11)	0.074	0.019
Financials	(3)	(9)	0.001	(0.013)
Health care	0	(5)	0.001	(0.062)

Table 4

Europe Risk-Reward Profiles By Sector--One Month Average R2P Score And Components Changes (cont.)				
Industrials	(16)	(8)	0.006	(0.006)
Information technology	(37)	(13)	0.025	0.105
Materials	(12)	(4)	0.009	0.037
Telecommunication services	(12)	(12)	0.002	(0.026)
Utilites	0	(9)	(0.004)	(0.022)
Average	**(10)**	**(9)**	**0.010**	**0.002**

One month change to Feb. 13, 2014. Source: S&P Capital IQ.

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Market Derived Signal Commentary: A Muted Reaction To Negative Housing News

Two separate reports this week indicated at least a temporary disruption in the U.S. housing market recovery, prompting the Global Markets Intelligence research team to search the S&P Capital IQ corporate credit default swap (CDS) database to determine the credit market's view of the situation.

On Wednesday, the U.S. Commerce Department said that housing starts in January of 880,000 fell 16% from the revised December estimate of 1,048,000 and declined 2% from January 2013. The 937,000 building permits were 5.4% below the December rate of 991,000, but rose 2.4% from January 2013.

On Tuesday, the National Association of Home Builders (NAHB)/Wells Fargo Index, which measures sentiment, dropped to 46 in February from 56 in January, indicating that more builders reported negative rather than positive market conditions. Within the index, confidence in current single-family sales declined to a score of 51 from 62, while the outlook for single-family sales over the next six months fell to 54 from 60, according to figures from the NAHB. Prospective buyer foot traffic retreated to 31 from 40, with the NAHB citing bad weather. "Builders also have additional concerns about meeting ongoing and future demand due to a shortage of lots and labor," the group said in a statement.

We believe weather may be only partly to blame (see more in Market and Economic Outlook). The situation is compounded by the fact that borrowing rates for mortgages, while still relatively low on a historical basis, are nevertheless on the rise. According to a report from Freddie Mac, the rate on a 30-year fixed rate mortgage averaged 4.28% for the week ended Feb. 13 versus an average of 3.53% in the comparable period a year ago. These additional costs may also be keeping some prospective buyers on the sidelines.

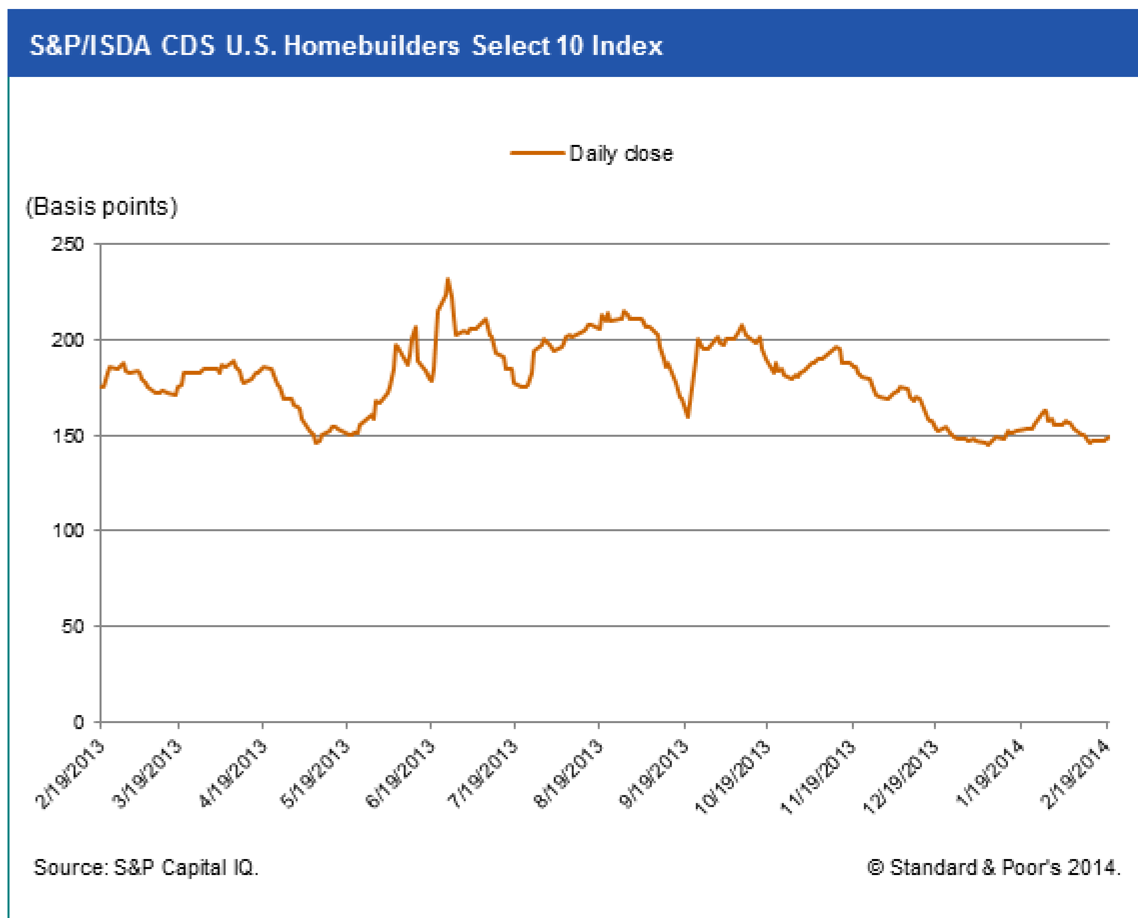
At the same time, S&P 500 homebuilding constituents have reported outstanding year-over-year growth in quarterly earnings, with DR Horton Inc.'s earnings per share (EPS) up 80%, Lennar Corp.'s EPS higher by 102.8%, and PulteGroup Inc.'s representing a 67.67% increase in their EPS, according to S&P Capital IQ. As a result, EPS for the household durables industry rose 36.1% for fourth-quarter 2013.

In its earnings release, DR Horton said it sees conditions improving across most housing markets and has a positive outlook for the spring selling season. For the first fiscal quarter, DR Horton said its net sales orders grew 14% to $1.5 billion, homes closed rose 33% to $1.6 billion, and the sales order backlog rose 20% to $2.1 billion. PulteGroup reported a gross margin of 23.2%, up 610 basis points (bps) from the year-ago period and the highest since 2005. PulteGroup expects the housing recovery to gain momentum in 2014, and as a result, it increased its estimated capital spending on land to $2 billion for full-year 2014 (ending Dec. 31) from $1.3 billion in full-year 2013. Lennar reported a 42% increase in revenue, a 27% gain in deliveries of homes, and a 40% rise in backlog to $1.6 billion. However, the company did say

that the "interest rate environment and our previously initiated price increases tempered new sales orders in the fourth quarter."

The average CDS spread for the S&P/ISDA CDS U.S. Homebuilders Select 10 Index (Homebuilders 10), a gauge of sentiment in the credit market, was 149 bps on Feb. 20, a widening of just 2 bps from the Feb. 18 session. At this level, the spread is 31 bps tight of its average of 180 bps over the past year (see "Credit Market Commentary: Market Derived Signal: The Credit Market Has A Different Take On Homebuilders" published June 20, 2013). The current spread is only 4 bps wide of the Market Derived Signal (MDS) consumer discretionary benchmark of 'bbb' and is 49 bps tight of Standard & Poor's Ratings Services benchmark rating of 'BBB-'.

Chart 13



Of the 10 constituents of the Homebuilders 10, which includes a home improvement retailer and two building products companies, all are trading tight of their respective benchmarks, which indicates that credit market investors may believe the risk of default is less than what their credit ratings would imply. We do note that over the past two days DR Horton's MDS dropped one notch to 'bb' from 'bb+', as did Home Depot's to 'a+' from 'aa-'.

Table 5

S&P/ISDA CDS U.S. Homebuilders Select 10 Index

Credit	CDS (bps)	Two-day change (bps)	Benchmark (bps)	CDS	ICR	Outlook/CreditWatch	Industry
DR Horton Inc.	160.0	9.3	367.8	bb	BB	Stable	Homebuilding

Table 5

S&P/ISDA CDS U.S. Homebuilders Select 10 Index (cont.)

Home Depot Inc.	28.0	2.4	68.1	a+	A	Stable	Home improvement retail
KB Home	298.7	9.1	550.0	b	B	Stable	Homebuilding
Lennar Corp.	204.6	4.7	420.6	bb-	BB-	Stable	Homebuilding
MDC Holdings Inc.	174.6	8.6	269.6	bb	BB+	Stable	Homebuilding
Masco Corp.	129.9	(9.5)	207.6	bb+	BBB-	Stable	Building products
Mohawk Industries Inc.	77.6	(0.2)	144.8	bbb	BBB	Stable	Building products
PulteGroup Inc.	163.5	2.4	367.8	bb	BB	Stable	Homebuilding
Ryland Group Inc. (The)	217.1	3.0	420.6	bb-	BB-	Stable	Homebuilding
Toll Brothers Inc.	154.9	2.7	269.6	bb+	BB+	Stable	Homebuilding

CDS--Credit default swap. Bps--Basis points. ICR--Issuer credit rating. Source: S&P Capital IQ.

The muted reaction may also mean that market participants are not considering the latest round of news as indicative of a housing market collapse. Sustained disappointing housing market related economic data, however, could change sentiment.

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

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

IPOs

With regard to deal size, IPO performance this year has been mixed. As indicated below, of the 12 issues raising $100 million or more in their IPOs, the average price gain from the offer price was 18.4%. At the other end of the spectrum, the six issues raising $50 million or less in their IPOs have seen an average price change of -0.5% from their debut price. Additionally, among the top 10 IPOs priced this year, only two are currently trading below their offer price. Conversely, of the 10 smallest IPOs completed this year in the U.S. market, five are trading underwater. To this end, a general rule for IPOs this year is that size matters for performance.

Table 6

IPOs Priced So Far In 2014 Ranked By Size

Effective date	Issuer	Total transaction value (mil. $)	Price per share ($)	Latest day close price ($)	Change (%)
1/22/2014	Santander Consumer USA Holdings Inc.	1,799.8	24.0	25.4	5.90
1/23/2014	Rice Energy Inc.	924.0	21.0	23.9	13.70
1/16/2014	EP Energy Corp.	704.0	20.0	18.5	(7.70)
1/16/2014	RSP Permian Inc.	390.0	19.5	24.4	25.10
2/5/2014	Ladder Capital Corp.	225.3	17.0	17.3	1.50
2/11/2014	Talmer Bancorp Inc.	202.2	13.0	14.0	7.30
1/15/2014	American Capital Senior Floating Ltd.	195.0	15.0	14.4	(4.00)
1/30/2014	Intrawest Resorts Holdings Inc.	187.5	12.0	14.0	16.70
2/4/2014	Continental Building Products Inc.	164.7	14.0	17.0	21.40
1/30/2014	Ultragenyx Pharmaceutical Inc.	121.0	21.0	44.0	109.50
1/30/2014	Malibu Boats Inc.	100.0	14.0	17.9	27.80

Table 6

IPOs Priced So Far In 2014 Ranked By Size (cont.)					
2/5/2014	Cm Finance Inc.	100.0	15.0	15.5	3.20
2/4/2014	Revance Therapeutics Inc.	96.0	16.0	26.8	67.20
1/23/2014	Care.com Inc.	91.0	17.0	25.4	49.50
1/29/2014	Dicerna Pharmaceuticals Inc.	90.0	15.0	39.0	159.70
1/30/2014	The New Home Co. LLC	85.9	11.0	12.7	15.10
2/4/2014	Auspex Pharmaceuticals Inc.	84.0	12.0	23.9	99.40
2/12/2014	Concert Pharmaceuticals Inc.	84.0	14.0	14.1	0.50
2/12/2014	Installed Building Products Inc.	82.0	11.0	13.0	18.20
1/14/2014	Cypress Energy Partners L.P.	75.0	20.0	24.8	24.00
2/4/2014	Genocea Biosciences Inc.	66.0	12.0	11.5	(4.20)
2/11/2014	Flexion Therapeutics Inc.	65.0	13.0	15.1	15.80
1/30/2014	Trevena Inc.	64.8	7.0	6.9	(1.60)
1/9/2014	GlycoMimetics Inc.	56.0	8.0	10.4	29.90
1/30/2014	Cara Therapeutics Inc.	55.0	11.0	13.2	20.40
2/5/2014	Egalet Ltd.	50.4	12.0	12.1	0.80
2/11/2014	Eagle Pharmaceuticals Inc.	50.3	15.0	12.8	(14.70)
2/5/2014	Eleven Biotherapeutics Inc.	50.0	10.0	11.3	13.10
2/6/2014	Argos Therapeutics Inc.	45.0	8.0	8.1	1.00
1/29/2014	Celladon Corp.	44.0	8.0	7.6	(5.60)
2/10/2014	NephroGenex Inc.	37.2	12.0	11.9	(0.80)
2/12/2014	Amedica Corp.	20.1	5.8	5.7	(1.20)
2/4/2014	Biocept Inc.	19.0	10.0	9.1	(9.40)

Source: S&P Capital IQ.

M&A

With regard to merger and acquisition (M&A) activity, 2013 was a year of counter trends for the health care sector. While overall U.S. M&A activity climbed to more than $1 trillion last year, its best showing since 2007, health care deal proceeds continued to slide and volume sank to less than $100 billion for the first time since 2004. Though some have contended that the Affordable Care Act, which took effect last year, may have pushed some deal makers to the sidelines, it appears that health care M&A is on the rebound. With Actavis PLC's recent move to acquire Forest Laboratories Inc. for approximately $25 billion on Feb. 17 to Carlyle Group L.P. agreeing to acquire Ortho-Clinical Diagnostics Inc. from Johnson & Johnson for $4.2 billion on Jan. 16, 2014, the appetite for health care deal activity appears to be on the rise. The GMI group will continue to monitor developments in this area.

Table 7

Announced U.S. Health Care M&A Transactions

Year	Deal volume (bil. $)	Deal count
2000	146.0	636
2001	67.3	578
2002	90.1	533
2003	47.3	617
2004	59.7	781
2005	122.1	903

Table 7

Announced U.S. Health Care M&A Transactions (cont.)		
2006	156.1	1,014
2007	147.2	1,150
2008	122.6	1,000
2009	187.6	918
2010	120.0	1,280
2011	173.1	1,373
2012	112.1	1,401
2013	98.3	1,382
2014*	42.7	213

*Year-to-date. Source: S&P Capital IQ.

Debt

Whether it was a result of the recent bout of harsh weather or the concern about the direction of interest rates, the recent data on the number of identifier requests for debt-related securities was decidedly downbeat. The week ended Feb. 7 saw nearly 1,000 CUSIP orders for the debt security classes profiled below, but the following week saw orders slashed by more than half. The recent results find only short-term municipal note CUSIP requests rising from the prior year's results. In all other security classes profiled below, demand has been lower, with municipal identifier requests dropping by 30%. We will wait to see if a turnaround occurs next month near the end of first-quarter 2014.

Table 8

Selected Debt CUSIP Requests

	Week ending 2/14	Week ending 2/7	2014*	2013*	Change (%)
Domestic corporate debt	66	655	1,445	1,581	(8.60)
Municipals	219	183	1,164	1,678	(30.60)
Short-term municipal notes	18	30	157	152	3.30
Long-term municipal notes	4	5	36	53	(32.10)
International debt	41	57	284	326	(12.90)
PPN domestic debt	67	66	313	337	(7.10)
Total	415	996	3,399	4,127	(17.60)

*Year-to-date. Source: CUSIP Global Services.

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