S&P CAPITAL IQ
McGRAW HILL FINANCIAL

THE OUTLOOK

INTELLIGENCE FOR THE INDIVIDUAL INVESTOR

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What's Inside

Don't Fight the Fed

Low rates and rising profits are behind the market's rally.

Legendary investor Martin Zweig died this February, ending an era for those who spent Friday nights watching PBS's "Wall Street Week." While often credited with predicting the October 19, 1987 market crash, Zweig perhaps more importantly coined the phrase "Don't fight the Fed," a bit of advice investors have taken to heart as perhaps none other.

Testimony by Fed Chairman Ben Bernanke before Congress, as well as the release of minutes from the Federal Open Market Committee's latest meeting, sent rumblings through the market as investors strained for any indication the Fed might alter its massive $85 billion monthly program of "quantitative easing." Economic data has been somewhat positive lately, with initial jobless claims falling in the week ended May 18 and new home sales surging in April. Addressing the question of "whether a recalibration of the pace of its purchases is warranted," Bernanke said only that "the Committee will continue to assess the degree of progress made toward its objectives in light of incoming information."

Still, indications in the minutes that at least some committee members are starting to ponder slowing the pace of quantitative easing were enough to halt the latest surge and leave the market lower on the week for the first time in a month.

While the current 7.5% unemployment rate is still well above the 6.5% the Fed is targeting before it begins to back off its low rate policy, much of the weakness is coming from government cutbacks rather than corporate layoffs, says Beth Ann Bovino, Deputy Chief Economist at Standard & Poor's Economics. "The private sector momentum is incredibly strong," she says. "They're able to handle these shocks really well."

The powerful rally that U.S. stocks have experienced so far this year has been repeated in many other corners of the world, most notably in Japan, where even more aggressive easing efforts are underway. Weak growth and low rates of inflation in the U.S., Japan, and in Europe are "giving central banks around the world more latitude to use monetary policy easing to jumpstart sluggish

(Continued on page 12)

TARGETS

12-Month S&P 500:	1670
S&P 500 EPS 2013E:	$110.49
S&P 500 EPS 2014E:	$112.64
Year-End 2013 S&P Euro 350:	1230
Year-End 2013 S&P Asia 50:	3800
Year-End 2013 MSCI Emerging Markets:	1175
Federal Funds Rate 2013 Average:	0.2%
10-Year Note Yield 2013 Average:	2.1%
Real GDP Growth 2013:	2.5%
Real GDP Growth 2014:	3.2%
WTI Average/bbl. 2013:	$92.04
WTI Average/bbl. 2014:	$89.33

Source: S&P Capital IQ.

Intelligencer

Headlines, Highlights, and What's on Our Minds

PORTFOLIO CHANGES: Actavis (ACT 128.08 ★★★★) and CNOOC (CEO 182.71 ★★★★★) were added to the Platinum portfolio effective Tuesday May 21. Effective after the close of trading on Tuesday May 28, there will be several changes to the Master List portfolios. In the High-Quality Capital Appreciation portfolio, Qualcomm (QCOM 63.91 ★★★★★) replaces Automatic Data Processing (ADP 69.93 ★★★) and Rock-Tenn (RKT 100.67 ★★★★) replaces Oneok (OKE 47.56 ★★★). In the Total Return portfolio, Norfolk Southern (NSC 77.45 ★★★★) replaces Stanley Black & Decker (SWK 79.66 ★★★).

SENATE CRITICAL OF APPLE'S TAX PRACTICES: On May 21 a Senate subcommittee said Apple (AAPL 442.14 ★★★★★) held more than $100 billion cash offshore to avoid U.S. taxes. Apple CEO Tim Cook testified that Apple pays all of its taxes and does not rely on tax "gimmicks." Cook proposed a plan to lower U.S. corporate tax rates to about 25% from 35%. "We think Apple does a good job of appropriately looking to limit its tax obligations to enhance financial performance," says S&P Capital IQ Equity Analyst Scott Kessler. "We see the hearing as largely about perceived flaws in the U.S. corporate tax system, perhaps leading to reform." Kessler reiterated his strong buy opinion on Apple shares.

PFIZER TO SPIN OFF ANIMAL HEALTH BUSINESS: Pfizer (PFE 29.11 ★★★★) said it will spin off the remaining 80% of its Zoetis (ZTS 32.84 NR) animal health operations to focus on its prescription drug business. Pfizer stockholders have the option to exchange $100 of Pfizer shares for $107 of Zoetis shares. "The split-off allows Pfizer greater focus on its core higher-margin drug business," says Herman Saftlas, S&P Capital IQ equity analyst, adding it will boost earnings per share by reducing the number of shares outstanding.

S&P KEEPS STRONG BUY ON NPS PHARMACEUTICALS: On May 21, New Jersey-based NPS Pharmaceuticals (NPSP 15.25 ★★★★★) raised $85 million selling 6 million new shares. "We view the timing of the offering as opportunistic," says S&P Capital IQ Equity Analyst Steven Silver, "as the shares have appreciated more than 60% year-to-date." Silver expects NPS to use the proceeds to support the launch of Gattex (for short bowel syndrome). "We also think the new capital will support a launch of Natpara as soon as late 2014," he says. Natpara is being developed to treat hypoparathyroidism. ■

MARKET MEASURES

INDEX	CLOSE FRI. 5/24/13	% CHG. YEAR TO DATE	% CHG. PAST 52 WKS.	‡OPERATING —EARNINGS— 2012	E2013	†P/E RATIO FRI. 5/24/13	INDICATED ANNUAL DIVIDEND	% YIELD
S&P 500 Composite	1649.60	15.7	25.2	$96.82	$109.69	15.04	$35.19	2.13
S&P MidCap 400	1188.07	16.4	27.1	$54.54	$63.91	18.59	$17.44	1.47
S&P SmallCap 600	553.18	16.1	28.4	$21.62	$28.18	19.63	$6.88	1.24
S&P SuperComposite 1500	381.70	15.7	25.4	$21.73	$24.77	15.41	$7.81	2.05
Dow Jones Industrials	15303.10	16.8	22.9	...	...	...	...	...
Nasdaq Composite	3459.14	14.6	21.9	...	...	...	...	...
BBB Indus. Bond Yield (10-yr.)	4.03	0.21 □	-0.25 □			...	...	...

Data through 5/24/13. E-Estimated. †Based on estimated 2013 earnings. ‡Before special factors. □Actual change in yield (not percentage change). Sources: S&P Capital IQ and Thomson ONE.

S&P Capital IQ's *The Outlook*

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S&P CAPITAL IQ EVALUATION SYMBOLS

STARS Rankings

Our evaluation of the 12-month potential of stocks is indicated by STARS:

★★★★★ **Strong Buy**—Total return is expected to outperform the total return of a relevant benchmark by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

★★★★ **Buy**—Total return is expected to outperform the total return of a relevant benchmark over the coming 12 months, with shares rising in price on an absolute basis.

★★★ **Hold**—Total return is expected to closely approximate the total return of a relevant benchmark over the coming 12 months, with shares generally rising in price on an absolute basis.

★★ **Sell**—Total return is expected to underperform the total return of a relevant benchmark over the coming 12 months, and the share price is not anticipated to show a gain.

★ **Strong Sell**—Total return is expected to underperform the total return of a relevant benchmark by a wide margin over the coming 12 months, with shares falling in price on an absolute basis.

NR Not ranked.

Quality & Fair Value Rankings

Our appraisals of the growth and stability of earnings and dividends over the past 10 years for STARS and other companies are indicated by Quality Rankings:

A+	Highest	**B+**	Average	**C**	Lowest
A	High	**B**	Below Avg.	**D**	In reorganization
A-	Above Avg.	**B-**	Lower	**NR**	Not Ranked

Quality Rankings are not intended to predict stock price movements.

S&P Fair Value Rank: Using S&P's exclusive proprietary quantitative model, stocks are ranked in one of five groups, ranging from Group 5, listing the most undervalued stocks, to Group 1, the most overvalued issues. Group 5 stocks are expected to generally outperform all others. The Fair Value rankings imply the following: 5-Stock is significantly undervalued; 4-Stock is moderately undervalued; 3-Stock is fairly valued; 2-Stock is modestly overvalued; 1-Stock is significantly overvalued. As an input to the S&P Mutual Fund Ranking, S&P evaluates the weighted average Fair Value Rank of the underlying holdings of the mutual fund compared with its category.

3D Printing for Medical Devices

Isabelle Sender
S&P Capital IQ
Editorial

Braces, implants, even functional human tissue can be made with 3D printers.

As new uses are discovered for the emerging technology known as 3D printing, S&P Capital IQ believes one of the most exciting applications is in medical devices. 3D printing holds promise across the health care sector, says Phillip Seligman, S&P Capital IQ equity analyst.

Medical devices are typically customized, precision-engineered devices made with industrial materials on a small scale. "Metals melted together well in a short amount of time is an exciting development" in 3D printing, Dr. Phil Reeves, managing director of Econolyst, a 3D-printing and additive-manufacturing (AM) consultancy, told the Inside 3D Printing conference last month. Engineering better-fitting, stronger, and lighter devices in less time is now possible by manufacturing particle by particle directly from computer data, Reeves says.

Reeves says engineering better-fitting, stronger, and lighter devices in less time is now possible by manufacturing particle by particle directly from computer data without the need for jigs, fixtures, or mold tools. Instead of ink, 3D printing, also referred to as AM, applies materials one layer at a time to "print" a product. Seven different technologies qualify as AM, according to ASTM International, a worldwide standards-setting body.

Many of the hearing aids, prostheses, and dental braces available today are being printed by computer using computer-aided design software. Consultant Terry Wohlers believes the dental industry is "embracing AM in a big way," estimating more than 15,000 crowns or bridges are custom-manufactured "every day of the week" by Germany's privately held EOS GmbH.

Oxford Performance Materials received U.S. Food & Drug Administration (FDA) clearance in February for its bone-replacement products, OsteoFab, which adapts an EOS printer to use a special polymer material suitable for human implants. The company's product was used to replace 75% of a patient's skull in March — the first U.S. surgical operation of its kind.

Other private medical-device companies using AM include Italy's Limacorporate S.p.a., where 2% of its 40,000 acetabular cups for hip implants are custom-made with AM, Wohlers estimates. Two private eyewear companies, pq Eyewear and MYKITA, both use AM, he adds.

Zack Schildhorn, vice president and director of operations, at venture-capitalist firm Lux Capital, says 95% of the world's in-the-ear hearing aids are fabricated using AM. "It doesn't make sense to do it the old fashion way," he told Inside 3D Printing attendees

Among public companies, a unit of Align (ALGN 36.98 ★★★) is using AM to make clear dental braces. The division, Invisalign, is one of the largest users of 3D printing in the world, Schildhorn says. Bespoke Innovations, acquired by 3D Systems (DDD 46.55 NR) last year (May 2012), designs and manufactures prosthetic leg covers for existing prosthetics, thereby recreating the body form through an AM process.

Exactech (EXAC 18.18 NR) was the first U.S. orthopedic device company to offer FDA-cleared orthopedic implants manufactured through an AM process called electron beam melting. Lockheed Martin's (LMT 106.30 ★★★) Sandia owns the trademark for the Laser Engineered Net Shaping 3D Metal Printing systems.

Among users of the technology, Medical Modeling's Christiansen claims Stryker (SYK 67.24 ★★★), Zimmer Holdings (ZMH 79.95 ★★★), Johnson & Johnson (JNJ 87.21 ★★★★), and Wright Medical Group (WMGI 23.73 ★★★) all employ AM in some form or another in manufacturing or testing processes.

Thinly traded Organovo Holdings (ONVO 4.18 NR) develops 3D-bioprinting technology for creating functional human tissues on demand for research and medical applications. With the increased use of 3D-imaging technologies, Dr. Laurence Bonassar, associate professor of biomedical engineering at Cornell University, believes image-guided tissue engineering will also be possible in a few years. "We are very much at the cusp at the revolutionary approach to medicine... three or four years from now I can come back with many more examples of 3D-printing technology in medicine," he told Inside 3D Printing attendees. ■

DISH Network Stalks Wireless Carriers

Vaughan Scully
S&P Capital IQ
Editorial

Waging a battle with Softbank for Sprint, and with Sprint for Clearwire.

It's been only four years since the "triple play" bundles of voice, Internet, and pay-TV service have been available from cable television and telecom companies in the U.S. While revolutionary at the time, they have now become so common — and the market for those services has changed so drastically — that they have almost become an afterthought for consumers who can access almost everything imaginable through a smartphone.

For DISH Network chairman and majority shareholder Charlie Ergen however, the triple play bundle is an unrealized dream he is still pursuing with vigor. DISH, the largest satellite pay-TV service in the U.S., has spent billions buying up rights to spectrum to enter the lucrative world of wireless voice and data. DISH might even be able to leapfrog the current triple play offers, which offer only landline voice service, to offer mobile voice and data together with pay-TV and Internet service.

Hoping to jumpstart that process, DISH has been making overtures to wireless service providers about joining forces. In August 2012, according to a report in *The Wall Street Journal*, it tried to buy prepaid wireless carrier MetroPCS. MetroPCS later agreed to be acquired by T-Mobile US, a move that united the fourth and fifth largest U.S. wireless carriers. DISH also tried unsuccessfully to acquire T-Mobile U.S. itself from parent Deutsche Telecom, according to a Bloomberg report.

Since then, DISH has moved on to even bigger quarry, and is now in the midst of a battle for beleaguered wireless carrier Sprint, which has already agreed to sell a 70% stake in itself to Japanese wireless carrier Softbank for $20.1 billion. As an alternative, DISH is offering $25.1 billion in cash and stock for 100% of Sprint. To complicate matters further, DISH is also bidding against Sprint for control of Clearwire, which owns the 4G mobile network Sprint markets to its customers and is 50% owned by Sprint.

The acquisition of Sprint by DISH would "likely have a profound impact on the competitive dynamics of the U.S. telecom landscape," says Tuna Amobi, S&P Capital IQ equity analyst, who has a "buy" recommendation on DISH shares. "This combination would unite the third largest U.S. pay-TV provider with the third largest U.S. wireless operator."

Whether it actually happens, however, is anyone's guess. Sprint shareholders will vote on the Softbank proposal on June 12. A vote by Clearwire shareholders was canceled after Sprint raised its initial offer.

S&P Capital IQ Equity Analyst Jim Moorman sees Softbank eventually winning control of Sprint, though concerns have been raised in Congress regarding the security issues surrounding a foreign company taking over such an important part of the national communications infrastructure.

Even if DISH is unable to acquire Sprint or Clearwire, it will still have large and highly valuable spectrum holdings that could be used in a partnership or other venture. Unconfirmed reports have suggested that Google or Apple could use their enormous cash holdings to bankroll a stronger competitor to AT&T and Verizon, and DISH could be a part of that.

What type of wireless venture DISH is able to enter will likely shape the company for years to come. "DISH's contemplated entry into the U.S. wireless market (versus a saturated pay-TV market) has increasingly become a crucial element of our investment outlook," Amobi says. ■

WIRELESS STOCKS

NAME / SYMBOL	STARS	PRICE	12 MONTH TARGET PRICE	YIELD	P/E RATIO	MARKET CAP (MLNS)	FAIR VALUE RANK	QUALITY RANK
Apple / AAPL	5	$442.14	$550.00	2.70%	10.82	$415.20	4	B+
Google / GOOG	3	$882.79	$925.00	Nil	22.78	$236.15	4	B+
DISH Network / DISH	4	$39.39	$44.00	Nil	19.51	$9.39	1	B
Sprint / S	3	$7.31	$7.50	Nil	NA	$22.06	NR	B
Clearwire / CLWR	NR	$3.42	NA	Nil	NA	$2.39	NR	NR
TMobile US / TMUS	NR	$20.38	NA	Nil	NA	$5.96	NR	NR
Verizon Communications / VZ	3	$51.89	$53.00	3.90%	18.34	$150.90	1	B
AT&T / T	3	$36.74	$40.00	4.80%	14.73	$199.23	3	B+

Source: S&P Capital IQ. P/E ratio is based on 2013 estimated operating EPS. STARS and Quality Ranking are defined on page 2. NA-Not available.

Airline Profits Now Arriving

Jim Corridore
S&P Capital IQ
Equity Analyst

Strategy shift has reduced some of the industry's operating risk, we believe.

S&P Capital IQ has a positive 12-month fundamental outlook for the U.S. airline industry. We see airlines as having shifted their strategy from a "market-share-at-all-costs" mentality toward one focused on earning a sustainable profit and return on invested capital. As a result of this strategy shift, the industry has fundamentally changed in ways that we think have reduced some of its operating risk.

Make no mistake, we still view the airline sector as a high-risk industry. Since 2000, there have been 60 bankruptcies in the industry. The industry is highly capital-intensive and cyclical. Airplanes are costly to buy and maintain, and customers tend to purchase the low-cost alternative even when offered a superior product.

After several years of profitability, U.S. airlines have generated a large amount of cash and are using it to pay down debt and buy back stock. Delta Air Lines (DAL 18.49 ★★★★) recently announced it will pay a $0.06/share quarterly dividend, a move that we think sends a strong positive signal about the company's long-term prospects.

With capacity tight and the U.S. economy recovering, we expect pent-up demand for business and leisure air travel to drive airfares higher. Ancillary fees like bag fees, ticket change fees, and fees for extra legroom have helped restore profitability to the U.S. airline industry since they add revenue without much added cost. Oil prices, the industry's largest cost category, are historically high but they have stayed below $100 a barrel. Entering the seasonally strong summer travel season with tight capacity and jet fuel prices likely to be slightly lower than last year, airlines should see strong profitability this year, we think.

We have buy recommendations on several airlines: Delta Air Lines, Southwest Airlines (LUV 14.37 ★★★★), US Airways Group (LCC 18.19 ★★★★), and Alaska Air Group (ALK 59.16 ★★★★). Here's why we like each of them.

Delta completed its 2008 merger with Northwest Airlines and is generating a significant revenue premium to peers as a result. The airline generates strong cash from operations and paid down about $6 billion of debt during the past three years. The company recently announced a share repurchase program. While the shares trade above their peers on an enterprise-value-to-EBITDAR (EBITDA plus aircraft rent) basis, we think this premium is warranted given Delta's strong global network and unit revenue premium to peers.

Southwest Airlines has been profitable for its entire operating history, a remarkable feat for an airline. It has one of the industry's lowest unit cost structures, which it achieves by running a very efficient network, employing better asset utilization than peers, and using a less costly point-to-point network instead of the hub and spoke model used by peers, according to S&P Capital IQ analysis. We think the company has the healthiest balance sheet among U.S. peers, with a debt to capital ratio of about 40%.

US Airways has long had a network disadvantage versus its larger network carrier peers. However, the company recently entered into a definitive merger agreement with the parent company of American Airlines (now operating under Chapter 11 bankruptcy protection), which we think solves US Airways's international route network problem. The merger, which has been approved by the bankruptcy court but is still subject to regulatory approvals, would make the combined company the largest airline in the world, with a strong global route network and the opportunity for major revenue and cost synergies. We expect US Airways to be able to successfully close the merger, but we like the company even on a standalone basis due to its below average unit costs.

Alaska Air Group has made great strides in reducing the seasonality of its business by adding routes to Mexico and the Caribbean, in our view, and was strongly profitable in the first quarter of 2013. It also has much less debt than peers, and as a smaller airline than the rest, has been able to grow faster than peers. We expect Alaska Air to grow capacity faster than its peers, which should lead to above average profit growth as well. ■

Focus Stock: Aflac

Insurance for Japan's aging population.

Robert McMillan
S&P Capital IQ
Equity Analyst

The Focus Stock for the week ended May 26 is Aflac, which carries S&P Capital IQ's highest investment recommendation of 5-STARS, or "strong buy." In our view, Aflac is well positioned to benefit from changing demographics and rising demand for health care in both the U.S. and Japan. We believe the company's expansive distribution channels, solid business mix, operational efficiencies, and financial strength will help it to maintain its earnings and profitability momentum.

Aflac provides supplemental health and life insurance in the U.S. and Japan. Most of Aflac's policies are individually underwritten and marketed at places of employment through independent agents. Premiums are paid by the employee. As of December 2012, Aflac believed it was the world's leading underwriter of individually issued policies marketed at work sites.

Aflac Japan accounted for 77% of the company's total revenue in 2012, and 87% of company assets. We see sales in Japan posting mid-to-high single digit growth in 2013. We estimate that Aflac Japan's pretax profit margins will be about 21% in 2013 despite increasing competition and pressure on prices.

Aflac Japan's insurance products are designed to help pay for costs that are not reimbursed under Japan's national health insurance system. Products include cancer life plans (13% of total Japan sales in 2012), medical plans (18%); and stand-alone whole life medical plans. Aflac Japan also offers ordinary life insurance products (65%).

For Aflac's U.S. business, we expect 2013 revenue growth in the low single digits, as sputtering U.S. economic growth, sluggish hiring by small businesses, and increasing competition curbs sales. We see the company's aggressive push into the large-case group benefits market contributing to long-term growth.

Aflac U.S.'s strategy hinges on insurance products to provide supplemental coverage for people who already have major medical or primary insurance coverage. Most of its U.S. policies are individually underwritten and marketed through independent agents. Aflac started to market and administer group insurance products in 2009. Group insurance policies are underwritten on a group basis and often have some element of guaranteed issue.

Aflac U.S.'s products fall into three major categories. The income loss protection line (26% of 2012 U.S. total sales) consists of short-term disability and life insurance. Asset-loss protection (53%) includes accident (30%) and critical care (23% including cancer, critical illness, and hospital intensive care products). Supplemental medical (21%) consists of hospital indemnity and dental/vision.

According to Aflac, it is the largest life insurer in Japan in terms of individual policies in force. As of December 31, 2012, the company had more than 22 million individual policies in force in Japan. Long term, we look for Aflac's Japan business to benefit from the aging population, increased patient co-payments, as well as strong product distribution through its marketing relationships with banks.

At recent price levels, Aflac shares are trading at about 1.7-times book value, and 8.3-times our forward four-quarter operating earnings per share (EPS) estimate of $6.57.

Our 12-month target price of $62 is based on a multiple of about 9-times our forward four-quarter operating EPS estimate. Although this values the shares at a premium to post-2008 levels, it still represents a discount to pre-2008 levels. We believe that a return to more normalized markets and trading conditions will allow the valuation multiple to expand. Our target price is about 1.5-times our forward four-quarter book value estimate, which is a slight discount to recent levels.

We believe that Aflac will be able to leverage its strong brand name, significant distribution capabilities, and leading position in the supplementary life and health insurance area to increase sales and earnings. With a strong earnings outlook for 2013 and beyond, in our estimation, we anticipate significant upside potential for Aflac shares over the next 12 months. ■

AFLAC

Ticker: AFL

Current Price: $55.06

12-Month Target Price: $62.00

Market Cap: $25.7 billion

Quality Rank: A-

Fair Value Rank: 5

P/E Ratio: 7.96

Yield: 2.50%

Source: S&P Capital IQ.

Top-Ranked ADRs

These foreign companies garner S&P Capital IQ's highest ranking.

Beth Piskora
S&P Capital IQ
Editorial

Maintaining a commitment to international diversification can be nerve-wracking for some investors, especially considering the recent news flow from overseas, including a potential slowing of economic growth in China, concern about Greece's potential exit from the eurozone, and renewed volatility in emerging markets.

Yet the S&P Capital IQ Investment Policy Committee recommends maintaining a portfolio diversified across asset classes and geographies.

One way to accomplish the goal of having international equity exposure may be to invest in S&P Capital IQ's top-ranked foreign companies trading in the U.S. Six companies with American depositary receipts (ADRs) garner a 5-STARS ranking from S&P Capital IQ equity analysts, suggesting the likelihood of significant outperformance in the next 12 months. They are listed in the table.

Four are holdovers from the last time this screen was published, in May 2012: Baidu, CNOOC, Icon, and Rio Tinto.

The latter is one of the world's largest mining companies, with headquarters in London. Its top two markets, in terms of total revenues, are China and North America. Our recommendation is strong buy. The shares underperformed in 2012, in our view, due to fears over China's slowing growth and, in turn, its demand for iron ore. We believe these fears are overdone, and given limited supply growth seen for this commodity until 2014, our expectations are for slower but robust Chinese demand growth (3%-5% a year). We believe these points support a rebound in iron ore prices in 2013, but, on our estimates, the market is discounting prices that are closer to the lows seen in September ($100/ton), by our analysis. Overall, we expect profits to remain historically high in 2013, but we think this is not appropriately reflected in the valuation of the ADSs.

Three of the companies on the list are based in China. Baidu is the clear leader in the Chinese online search segment, and we think it has notably improved its related offerings and efficiency. The company has recently gained market share, especially given uncertainties about Google's offerings in China. We also see significant potential in adjacent areas such as contextual and display advertising, and certain types of search-related or search-driven content and communications.

CNOOC is China's largest offshore producer of crude oil and natural gas. S&P Capital IQ believes the energy company has a solid business profile, a strong balance sheet, and good underlying fundamentals. In July 2012, CNOOC announced a deal to acquire Canadian exploration & production (E&P) company Nexen for $15.1 billion. We estimate the deal value at about $20/barrel of oil equivalent (boe), which is about 90% above CNOOC's other recent deals, but warranted, in our view, by lower regulatory risk and by the control premium. We see it as a positive for CNOOC, given greater access to technology and a boost to reserves and production.

China Unicom provides both wireless and wireline telecommunication services in China. We estimate revenue growth of 12% in 2013, following 19% growth in 2012, in local currency. In the first quarter of 2013, CHU's third-generation (3G) wireless subscribers grew 80% from the prior year, to 88 million, and are now 35% of total subscribers. Mobile average revenue per user increased 0.6%, as 3G broadband data growth offset voice declines. In wireline, broadband subscribers grew 14%, but access lines declined 1%. We see mobile data driving revenue growth, but declining voice revenues dampening the company's overall growth rate.

One more company to make the cut is Ireland's Icon, a health care services company that provides clinical research and development services. We believe the company's selection by Pfizer as one of two preferred providers highlights the company's breadth and depth of services, as well as its global reach. We also believe the company is well positioned to gain market share from smaller competitors.

We like Ericsson's market share in mobile infrastructure, and see a strong patent portfolio and growing software business. We expect 2013 sales growth to accelerate and see a mix shift towards more higher-margin capacity projects, which should drive higher gross margins through 2014. ■

STOCK SCREEN OF THE WEEK

COMPANY/TICKER	CURRENT PRICE	12-MONTH TARGET PRICE	RISK	P/E RATIO (TTM)	YIELD
Baidu / BIDU	$93.89	$110.00	High	20.8	Nil
China Unicom / CHU	$14.08	$18.00	High	18.6	1.1%
CNOOC / CEO	$182.71	$271.00	Medium	7.5	2.8%
Ericsson / ERIC	$11.70	$15.00	High	13.9	2.4%
Icon / ICLR	$33.43	$40.00	Medium	21.4	Nil
Rio Tinto / RIO	$44.19	$64.00	Medium	6.6	3.7%

Source: S&P Capital IQ. Risk is based on our analysts' assessment of qualitative factors, including financial strength, potential share volatility, competitive position, industry cyclicality, regulatory/legal issues, and other factors. Please note that all investments carry risks.

FUND STRATEGIES

Hodges Finds Success with Small Caps

Beth Piskora
S&P Capital IQ
Editorial

Strong performance has drawn a large inflow of assets.

Hodges Small Cap fund held only 76 stocks as of the end of March, yet the fund manager and seven associates met or talked with more than 2,500 companies last year to hone in on those 76.

This depth of research has paid off for the fund, launched in 2007, which has delivered top-quartile performance for the past one, three, and five years. In 2012, the fund recorded a 20.7% total return, and it's up 21.1% in 2013 through May 20. Such strong performance has brought attention and assets; the fund had only $80 million in assets under management at the end of 2011, but they've grown to more than $425 million today.

Effectively, that means the younger sibling is now the bigger kid. Hodges Capital Management, based in Dallas, launched its eponymous Hodges all-cap fund (HDPMX 29.04 ★★★) in 1992 and it has about $150 million in assets today.

"We did a deep dive and saw all the outperformance came from the small-cap space, so we decided to launch a small-cap fund," says Craig Hodges, CEO, CIO, and portfolio manager of both funds.

The fund garners the top five-star ranking from S&P Capital IQ's unique fund ranking methodology, which incorporates an analysis of holdings, risks, and costs, in addition to past performance. Hodges Small Cap fund gets positive inputs from S&P Capital IQ on its manager tenure (Craig Hodges has managed it since its launch in 2007), its Sharpe ratio, and its lack of front-end sales load.

Three of the top-10 holdings are ranked strong buy or buy by S&P Capital IQ analysts, and four of the 10 have S&P Capital IQ Quality Rankings of B+ or higher.

Although close to 90% of the assets are invested in U.S. stocks, Hodges says one of the big themes explored by the team is Mexico.

"Mexico is opening a big port on the west coast to alleviate pressure on the Long Beach {California} port," he explains. "The port will be used to ship cars to the U.S. from Mexico. We also see a lot of companies moving manufacturing out of China and into Mexico. They pay higher wages, but you save so much on transportation."

One of the fund's holdings is Kansas City Southern (KSU 112.00 ★★★) as Hodges expects it to benefit from Mexico's new port and manufacturing capabilities.

The fund also owns Cinemark (CNK 30.11 NR), which garners 40% of its revenues from movie theaters in Latin America. Hodges sees the company benefiting from the region's growing middle class.

The fund's top holding is US Airways Group (LCC 18.19 ★★★★). "We see big opportunity in the airlines," comments Hodges. "This is a business that needed consolidation and right-sizing, and now it's going through all that. We think US Air is a cheap stock."

In terms of sector exposure, the fund has the most exposure to industrials (28.73%), followed by consumer discretionary at 24.11%; all stats are as of March 31.

Energy may be the fund's third largest sector exposure, at 14.35% of assets, but it's one the managers follow closely. "We love energy; hey, we're from Texas," laughs Hodges, who mentions positions in Atwood Oceanics (ATW 55.28 ★★★★), Transocean (RIG 51.96 ★★★), Schlumberger (SLB 75.38 ★★★), and Halliburton (HAL 43.52 ★★★). ■

HODGES SMALL CAP FUND

Ticker: HDPSX

S&P Ranking: ★★★★★

Current Price: $15.72

Total Assets: $433 million

12-Month Total Return: 34.39%

Total Return Since Inception (Average Annualized): 10.77%

Inception Date: 12/18/2007

Annual Expense Ratio: 1.41%

Source: S&P Capital IQ.

ETF STRATEGIES

Sizing Up the High Yield Alternatives

S&P Capital IQ's new ranking system can help.

Todd Rosenbluth
S&P Capital IQ
Director of ETF Research

If you thought the rally in junk bonds has made them less desirable for investors, think again. Some $10 billion flowed into exchange traded funds (ETFs) that own high yield bonds in 2012, and an additional $1 billion arrived in the first four months of 2013. We think the strong demand for these fixed income funds is tied to the low interest-rate environment and robust corporate profitability. But that's the past — what should investors be mindful of going forward?

Relative to the last five years, the yield spread between speculative-grade bonds and U.S. Treasuries is currently 39% below the 745 basis points average. We think the tight spread is partially the result of historically low yields for the 10-year Treasury note, which dipped all the way down to 1.66% in May before rising again to about 1.9% currently. We also think investors have become increasingly optimistic about corporate profits as well. S&P 500 Index companies reported a record $26.70 in earnings per share (EPS) for the first quarter as of May 16, and consensus expectations are for 6.8% EPS growth in 2013 compared with 4.5% in 2012.

Meanwhile, Standard & Poor's Ratings Services (which operates independently of S&P Capital IQ) expects the U.S. corporate trailing 12-month speculative-grade default rate will increase to 3.3% by March 2014 from the 2.5% rate seen in the 12 months ended March 2013. While a higher default rate is a modest concern, it should be noted that the long-term average default rate in the 1981-2012 period was 4.5%.

So what does this mean for ETF investors and what are some things they should know about the largest high yield offerings? S&P Capital IQ recently launched coverage of fixed-income ETFs, using an approach that combines holdings-based analysis about an ETF's credit and duration risks with information about its yield, liquidity, and expenses. The April 30-day SEC yields for the $16 billion-plus iShares iBoxx High Yield Corporate Bond Fund and State Street's $11 billion-plus SPDR Barclays High Yield Bond ETF were 4.7% and 4.9%, respectively, down from 4.9% and 5.1% a month earlier. While the recent yields are still appealing in light what is offered by Treasuries, in our opinion, there are elevated credit risks to consider as well.

Using holdings data as of March 2013, the iShares fund had 6.4% in bonds with BBB or equivalent ratings, 37% in bonds with BB ratings, 34% in bonds with B ratings, and 11% in bonds rated below B; non-rated bonds made up 9% of the portfolio. In contrast, the State Street fund had just 3.8% in BBB rated bonds, 32% in bonds with BB ratings, 35% in bonds with B ratings, and 9% in bonds with below B ratings; non-rated bonds made up 17% of the holdings. Despite fewer investment-grade holdings and more in bonds that are not rated, the State Street fund costs less. Both ETFs have tight bid/ask spreads and trade over three million shares per day on average. Neither takes on much interest rate risk, with duration of roughly five years, in line with most other ETFs.

We also see other strong alternatives, such as PIMCO 0-5 year High Yield Corporate Bond Index, which has over $2 billion in assets despite getting ready to turn two years old in June. The 30-day SEC yield is 3.2%, much lower than the others despite having more in bonds rated below B (14%). The positive offset for this ETF is that the duration is just 2.7 years, below the five-years-plus of its larger peers, making the PIMCO fund less sensitive to interest rate swings. ■

HIGH YIELD ETFs

FUND NAME / TICKER	CURRENT PRICE	YIELD	TOTAL RETURN 1-YEAR	3-YEAR*	5-YEAR*	EXPENSE RATIO	ASSETS (MLNS)
iShares iBoxx $ High Yield / HYG	$94.89	6.36%	14.60%	11.90%	8.03%	0.50%	$15,816.00
SPDR Barclays High Yield / JNK	$41.35	6.47%	14.99%	12.17%	8.04%	0.40%	$11,338.00
Pimco 0-5 High Yield / HYS	$105.85	5.09%	12.96	NA	NA	0.55%	$2,244.00

Source: S&P Capital IQ. *Average annualized. NA-Not available.

Total Return Portfolio

The Total Return Portfolio is focused on maximizing long-term total return. To enter the portfolio, a stock must have a current yield equal to or greater than that of the S&P 500. The company must not have cut its regular dividend in the last five years, and that dividend must be secure in the opinion of the S&P Capital IQ equity analyst who follows the stock. There is no Quality Ranking requirement for this portfolio. S&P Capital IQ's Senior Portfolio Group may replace any stock in the portfolio with another stock at any time for reasons that can include a downgrade in the STARS, a dividend reduction, or other fundamental factors.

This portfolio was launched on May 23, 2003. From that time through April 30, 2013, the portfolio has delivered an average annualized total return of 12.92%, compared with 7.73% for the S&P 500. For the period from December 31, 2012 to May 17, 2013, the portfolio had a total return of 19.68%, compared with 17.89% for the S&P 500. ■

TOTAL RETURN PORTFOLIO

SYMBOL	COMPANY NAME	ENTRY PRICE	ENTRY DATE	CURRENT PRICE	12-MONTH TARGET PRICE	STARS	YIELD
BAX	Baxter International	$66.95	01/22/2013	$72.15	$76.00	4	2.7
CVX	Chevron Corp.	$46.08	06/07/2004	$125.40	$142.00	5	3.1
CSCO	Cisco Systems	$19.36	08/27/2012	$23.51	$28.00	4	2.9
KO	Coca-Cola Co.	$23.66	03/19/2007	$41.93	$48.00	5	2.6
ESS	Essex Property Trust	$153.82	01/22/2013	$164.31	$187.00	4	2.8
HON	Honeywell International	$36.87	02/08/2010	$79.24	$81.00	4	2.0
ITC	ITC Holdings	$67.26	02/14/2011	$88.67	$106.00	5	1.6
KMP	Kinder Morgan Energy Ptnrs. L.P.	$48.04	11/24/2008	$88.20	$99.00	5	5.8
KLAC	KLA-Tencor Corp.	$47.80	11/14/2011	$54.94	$60.00	4	2.8
OMC	Omnicom Group	$58.55	04/22/2013	$61.52	$65.00	4	2.5
PM	Philip Morris International	$91.28	09/24/2012	$94.31	$103.00	5	3.6
SWK	Stanley Black & Decker	$73.43	12/24/2012	$79.66	$82.00	3	2.4
TROW	T.Rowe Price Group	$61.01	04/23/2012	$76.85	$87.00	5	1.9
UPS	United Parcel 'B'	$72.74	12/20/2010	$87.31	$100.00	4	2.7
WIN	Windstream Corp.	$9.61	06/25/2012	$8.69	$10.00	5	11.7

Source: S&P Capital IQ.

Performance calculations do not take into account reinvestment of dividends, capital gains taxes or brokerage commissions and fees. If the foregoing had been factored into the portfolio's investment performance, it would have been lower. This performance calculation also does not take into account timing differences between the portfolio selections and purchases made based on those selection by actual investors. Over certain periods, the portfolio incurred losses and over time the portfolio is expected to continue to pose a risk of negative investment returns. Because the portfolio has a high turnover rate, it is best suited for tax-deferred accounts such as IRAs and is less suited for other accounts. Investors should seek financial advice before investing based on the portfolio. This portfolio does not address the specific investment objectives, financial situation, and particular needs of any person. Stocks in the portfolio will not be suitable for all investors. Past performance is no guarantee of future results.

LEADERS

NAME	YTD GAIN/LOSS
Honeywell International	27.87%
Cisco Systems	24.23%
United Parcel Service	21.14%
T. Rowe Price	20.92%
Coca-Cola	19.31%

LAGGARDS

NAME	YTD GAIN/LOSS
Windstream	7.97%
Omnicom Group	8.13%
Baxter International	9.62%
Stanley Black & Decker	10.09%
Essex Property Trust	10.17%

Source: S&P Capital IQ. Current portfolio members only. Performance is based on the year to date through 5/10/2013, or, if the security was added after the start of the year, for the time it has been a portfolio member.

Neural Fair Value 25

Neural fair value rankings are derived from two quantitative stock selection systems proprietary to S&P Capital IQ: the neural model and the fair value model. The neural rank is based on "neural networks," an artificial intelligence system that replicates the brain's ability to learn from mistakes. The neural model identifies the factors that led to outperformance over the most recent six-month period and determines which stocks should benefit from those factors in the future.

Stocks are ranked in five tiers, from most attractive (5) to least (1). The fair value model calculates the price at which a stock should trade, based on data such as earnings and growth potential. Neural fair value rankings also include the earnings surprise indicator, which tags those issues most likely to beat earnings estimates, and the timing index, which tells investors whether or not a stock meets certain trend requirements that have proved favorable to long-term capital appreciation.

A stock is deleted from NFV 25 when its Neural rank drops under 3 and, either its Earnings Surprise rank drops under C, or its Timing Index goes negative ("-"). This deletion triggers an addition.

This portfolio was established on October 5, 2004. From that time through April 30, 2013, it has delivered an average annualized gain of 7.84% excluding dividends, compared with 4.08% for the S&P 500. From December 31, 2012 to May 17, 2013, the portfolio rose by 24.71% excluding dividends, compared with a 16.92% gain in the S&P 500. ■

NEURAL FAIR VALUE 25

SYMBOL	COMPANY NAME	ENTRY DATE	ENTRY PRICE	CURRENT PRICE	PRICE CHANGE	NEURAL	FAIR VALUE	***EARNINGS SURPRISE	TIMING
APOL	Apollo Group 'A'	04/16/2013	$17.91	$20.85	16.42%	3	5	A	+
AMAT	Applied Materials	05/22/2012	$10.54	$14.60	38.52%	3	2	A	+
CAH	Cardinal Health	11/24/2009	$32.31	$47.17	45.99%	3	4	A	+
CHKP	Check Point Software Tech.	11/06/2007	$24.68	$49.90	102.19%	4	4	C	+
CSCO	Cisco Systems	11/17/2009	$24.09	$23.51	-2.41%	5	5	B	N
CTRP	Ctrip.com Int'l ADR	05/07/2013	$23.54	$31.68	34.58%	3	1	A	+
CROX	Crocs Inc.	04/09/2013	$15.06	$16.82	11.69%	4	5	C	+
DV	DeVry Inc.	02/12/2013	$30.00	$30.86	2.87%	4	5	B	+
EBAY	eBay Inc.	03/27/2012	$37.87	$54.48	43.86%	3	4	C	N
RE	Everest Re Group	09/04/2012	$106.48	$127.64	19.87%	1	5	A	+
GT	Goodyear Tire & Rubber Co.	05/07/2013	$13.08	$14.58	11.47%	5	5	A	N
IGT	Int'l Game Technology	05/07/2013	$17.37	$18.00	3.63%	5	5	A	+
JAZZ	Jazz Pharmaceuticals Plc.	04/02/2013	$54.88	$63.00	14.80%	4	4	C	N
LNC	Lincoln National Corp.	03/19/2013	$32.35	$34.80	7.57%	4	5	E	+
LMT	Lockheed Martin	07/19/2005	$61.58	$106.30	72.62%	3	3	A	+
MRVL	Marvell Technology Group	04/09/2013	$10.41	$11.31	8.65%	5	5	A	+
NSR	NeuStar Inc. 'A'	11/05/2012	$36.82	$47.28	28.41%	5	5	C	+
PCLN	priceline.com Inc.	06/12/2012	$646.98	$803.60	24.21%	2	5	A	N
PL	Protective Life Corp.	02/19/2013	$33.52	$38.26	14.14%	3	4	A	+
ROVI	Rovi Corp.	03/19/2013	$21.02	$24.72	17.60%	5	5	D	+
LUV	Southwest Airlines	09/11/2012	$8.95	$14.37	60.56%	2	5	A	+
AMTD	TD AmeriTrade Holding	10/09/2012	$15.78	$22.32	41.44%	4	4	C	N
TPX	Tempur-Pedic International	04/27/2010	$33.45	$42.44	26.88%	5	5	C	+
TWX	Time Warner	11/30/2010	$29.49	$60.16	104.00%	2	3	A	+
UNH	UnitedHealth Group	10/27/2009	$26.50	$62.36	135.32%	4	5	C	+

Source: S&P Capital IQ. All data are as of Thursday's close. The earnings surprise indicator divides stocks into five tiers, designated by the letters A through E, based upon their ability to beat earnings estimates. "A" ranked stocks are most likely to show future positive earnings surprises, while "E" ranked stocks are most likely to report negative earnings surprises.

Performance calculations do not take into account reinvestment of dividends, capital gains taxes or brokerage commissions and fees. If the foregoing had been factored into the portfolio's investment performance, it would have been lower. This performance calculation also does not take into account timing differences between the portfolio selections and purchases made based on those selection by actual investors. Over certain periods, the portfolio incurred losses and over time the portfolio is expected to continue to pose a risk of negative investment returns. Because the portfolio has a high turnover rate, it is best suited for tax-deferred accounts such as IRAs and is less suited for other accounts. Investors should seek financial advice before investing based on the portfolio. This portfolio does not address the specific investment objectives, financial situation, and particular needs of any person. Stocks in the portfolio will not be suitable for all investors. Past performance is no guarantee of future results.

The Observatory

Selected actions for May 17 through May 23.

COMPANY / TICKER	NEW STARS	OLD STARS	STARS RANKING DATE	PRICE	12 MONTH TARGET PRICE	S&P QUALITY RANKING	S&P FAIR VALUE RANK
The Buckle / BKE	3	4	5/23/2013	$55.42	$57.00	A-	3
L Brands / LTD	3	4	5/23/2013	$51.19	$54.00	B+	1
Gentiva Health Services / GTIV	3	2	5/22/2013	$9.96	$10.00	C	3
Carnival / CCL	4	5	5/21/2013	$32.99	$38.00	NR	5
Carnival PLC / CUK	4	5	5/21/2013	$33.97	$38.00	NR	NR
Medtronic / MDT	**4**	3	5/21/2013	$51.46	$57.00	A	4
Xilinx / XLNX	**5**	4	5/20/2013	$39.21	$45.00	B	2
Actavis / ACT	4	5	5/20/2013	$128.08	$143.00	B-	5
Essex Property Trust / ESS	4	5	5/20/2013	$164.31	$187.00	B	1
Akamai Technologies / AKAM	3	4	5/20/2013	$46.35	$50.00	B	4
Exelon / ECX	3	2	5/20/2013	$34.72	$36.00	B+	NR
MDU Resources / MDU	3	4	5/20/2013	$26.04	$28.00	B	1
Bristol-Myers Squibb / BMY	**4**	3	5/17/2013	$47.00	$48.00	B+	1
Telephone and Data Systems / TDS	**4**	3	5/17/2013	$23.96	$26.00	B	NR

Source: S&P Capital IQ.

For daily STARS changes, subscribers can call *The Outlook* hotline, 800-618-7827, and put in your subscriber access code.

The Observatory provides a selection of analytical actions — upgrades, downgrades, initiations — from S&P Capital IQ. Stocks featured in the Observatory are selected by *The Outlook* according to factors including, but not limited to, newsworthiness, capitalization, and inclusion in a portfolio published by *The Outlook*. Please note that all investments carry risks. Investors should seek financial advice before investing.

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Don't Fight the Fed *[Continued from cover]*

growth," says Alec Young, S&P Capital IQ global equity strategist. Australia, South Korea, India, Mexico, and Turkey are now all following suit, he says, "boosting the global economic outlook."

First quarter earnings for S&P 500 companies have been running well ahead of consensus forecasts and now look to rise by 5.12%, 10-times the 0.5% gain seen in early April. That has helped underpin the rally, though further earnings growth will be needed if the market is to keep moving higher, Young says.

"Stocks appear fully valued to us, with the S&P 500 trading at 15.1-times estimated 2013 earnings per share," he says. A stronger global economy has analysts calling for 6.8% growth in S&P 500 earnings per share for the full 2013 calendar year, and a scorching 11% gain for calendar 2014. "We think it's a little early to price in that rosy expectation without at least seeing a solid second quarter earnings season and more robust payroll reports," Young says.

Hopes for sustained economic momentum and accelerating earnings growth within an environment of ultra-low interest rates are pushing U.S. stocks to record highs. It might not always be that way, but for now, "we think stocks deserve a near-term breather," says Young. ■

—*Vaughan Scully*
S&P Capital IQ Editorial