S&P
CAPITAL IQ

THE OUTLOOK

INTELLIGENCE FOR THE INDIVIDUAL INVESTOR

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The 7% Solution

The European Central Bank's plan sparks a global equity rally.

Going back at least to 2011, investors and policy makers have been operating under the assumption that European governments could not afford to fund themselves if the yield on their benchmark 10-year notes rose above 7%. The 7% line on trading screen graphs became the de facto indicator of the euro's future: cross it and face either the ignominy of a bailout or exile from the eurozone.

While some of Europe's smaller economies — Portugal, Ireland, and Greece — were unable to keep their yields below that line and ultimately accepted bailout packages to avoid default, the real problem arose when larger economies like Spain and Italy flirted with the line. As the eurozone lurched from crisis to crisis, political leaders searched for a solution that would raise investor confidence enough to keep the 7% line out of reach and preserve some stability for the region's common currency.

That solution appears to be at hand and global equity markets have rallied significantly as a result, with the S&P 500 closing in on its 2012 high set in April. The European Central Bank's plan calls for heavily indebted nations to request that EU's bailout fund — optimistically known as the European Stability Mechanism — buy sovereign debt in the primary market to keep yields from rising in exchange for agreeing to fiscal austerity measures. This plan appears to have gained the market's confidence, says Alec Young, S&P Capital IQ's global equity strategist. As a backstop, the ECB would also buy short-term sovereign debt in the secondary market. After crossing the 7% frontier on at least three occasions this year, the yield on Spain's 10-year note has fallen consistently since the ECB's solution was proposed.

Relief that the eurozone's sovereign debt crisis is finally moving toward some type of resolution has sapped some of the unprecedented strength of the U.S. Treasury market and pushed global equity prices to their highest levels in months. At the same time, new signs of economic strength in the U.S. are raising hope that a stronger recovery is at hand. U.S. retail sales posted a strong 0.8% gain in July.

(Continued on page 12)

CAPITAL IQ S&P 500 CONSENSUS Y/Y ESTS.

S&P 500 SECTOR	2012 EPS GROWTH Q2E	Q3E	Q4E
Cons. Discretionary	0.7%	5.0%	17.2%
Consumer Staples	2.4%	0.3%	5.8%
Energy	-12.0%	-20.3%	0.8%
Financials	0.3%	6.7%	23.1%
Healthcare	4.1%	-3.4%	1.7%
Industrials	13.3%	5.3%	7.4%
Info. Technology	6.3%	4.2%	11.8%
Materials	-16.0%	-20.3%	25.5%
Telecom Services	-2.6%	3.7%	6.5%
Utilities	-1.8%	-6.1%	2.7%
S&P 500	**0.8%**	**-1.6%**	**10.3%**

Source: S&P Capital IQ.

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Please see page 12 for required research analyst certification disclosures.

Intelligencer

Headlines, Highlights, and What's on Our Minds

PORTFOLIO CHANGES: Trinity Industries (TRN 29 ★★★★★) was added to and McDermott International (MDR 12 NR) was deleted from the Neural Fair Value 25 Portfolio effective Tuesday, August 14.

IT TOPS SECTOR DIVIDENDS: When Cisco Systems (CSCO 19 ★★★★) raised dividend by 75% to $0.14 per share, it became the 22nd largest dividend payer in the S&P 500 and made information technology the largest dividend paying sector, says Howard Silverblatt, senior index analyst at S&P Dow Jones Indices (which operates independently of S&P Capital IQ). Within the IT sector, 41 of 71 S&P 500 members now pay dividends. "Technology now accounts for 14.22% of all dividends in the S&P 500, a tick above the 14.21% paid by consumer staples," he says.

HOME OWNER SOLUTIONS: S&P Equity Analyst Richard Tortoriello sees "a rebound in residential housing activity in the U.S., from low levels, aiding Ingersoll-Rand's (IR 46 ★★★★) residential segment," and he expects commercial construction growth to follow over the next couple years. IR's residential solutions unit (14% of sales and 4% of operating profits in 2011) makes locks, heating and cooling systems, and security systems.

STRONG BUY FOR CERNER: Shares of Cerner (CERN 73 ★★★★★), which sells health care software and computer systems, have slumped in recent weeks, possibly because bookings of $701 million in new business during the second quarter did not exceed the company's previous forecast as they have in the previous eight quarters, says S&P Capital IQ Equity Analyst Jeffrey Loo. Even so, Loo is keeping his strong buy recommendation, noting second quarter bookings were the second highest in company history, and "robust proposal requests" bode well for the second half of 2012.

IMPROVED OUTLOOK FOR OIL REFINERS: S&P Capital IQ raised its fundamental outlook for the the oil and gas refining and marketing group to positive from neutral. The move "reflects our view that domestic refiners will benefit from wide crude oil differentials and higher global demand for refined products," says Tanjila Shafi, S&P Capital IQ equity analyst. "The wide crude oil differentials have given U.S. refiners a cost advantage over global refiners. We have a positive view of refiners' commitment to return cash to shareholders via dividends and share repurchases. We see the recent increases in dividends signaling the strength and sustainability of refining earnings." Shafi has buy or strong buy recommendations on five refining stocks, including Valero Energy (VLO 29 ★★★★★), World Fuel Services (INT 36 ★★★★★), HollyFrontier (HFC 40 ★★★★), Marathon Petroleum (MPC 50 ★★★★), and Phillips 66 (PSX 42 ★★★★). ■

MARKET MEASURES

INDEX	CLOSE FRI. 8/17/12	% CHG. YEAR TO DATE	% CHG. PAST 52 WKS.	‡OPERATING —EARNINGS— 2011	E2012	†P/E RATIO FRI. 8/17/12	INDICATED ANNUAL DIVIDEND	% YIELD
S&P 500 Composite	1418.16	12.8	20.5	96.44	101.86	13.92	31.77	2.24
S&P MidCap 400	977.85	11.2	17.0	50.31	58.25	16.79	14.78	1.51
S&P SmallCap 600	461.19	11.1	22.0	20.59	23.90	19.30	5.85	1.27
S&P SuperComposite 1500	326.63	12.6	20.3	21.50	22.91	14.26	7.02	2.15
Dow Jones Industrials	13275.20	8.7	17.6	...	...	...	...	...
Nasdaq Composite	3076.59	18.1	24.1	...	...	...	...	...
BBB Indus. Bond Yield (10-yr.)	4.06	-0.43 ◊	-0.65 ◊			...	...	...

Data through 8/17/12. E-Estimated. †Based on estimated 2012 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*

EDITORIAL

Senior Editorial Manager Vaughan Scully

Contributing Editors Brian J. Egli, Art Epstein, Isabelle Sender

Statistician Chris Peng

RESEARCH & ANALYTICS

Managing Director, Global Equity Research Stephen Biggar

Editorial Director Seth Piskora

For customer service, please call **1-800-852-1641** between 9am and 4pm Eastern Time, Monday through Friday.

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McGRAW-HILL

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 Rankings (QR)

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.

Utility Mergers Go from Hot to Cool

Justin McCann
S&P Capital IQ
Equity Analyst

Concessions to win regulatory approval make mergers less attractive, we believe.

Over the past two years, there has been a significant consolidation taking place within the electric utilities industry, with three major mergers completed this year. This rapid consolidation is likely to slow, however, as the number of merger candidates dwindle and regulatory hurdles prove more and more difficult to overcome, S&P Capital IQ believes.

After a lull of several years dating back to about 2006, the utility merger environment began to heat up in early 2010, with FirstEnergy announcing an agreement to merge with Allegheny Energy. The transaction increased FirstEnergy's customer base by about 33% and its power generating capacity by more than 65%. Two months later, PPL announced the $7.625 billion acquisition of Louisville Gas & Electric and Kentucky Utilities.

Exelon and Constellation Energy, which were each unsuccessful in completing previously announced mergers several years ago eventually did succeed in merging with each other, a transaction that was completed in March 2012. In their effort to obtain approval for the merger from the Maryland Public Service Commission, however, they offered a benefits package worth $1 billion to the state, an amount that doubled twice after the merger was initially announced in April 2011. The concessions made clear the importance the two companies placed on the completion of their merger. The combined company is now the largest competitive energy producer in the U.S. and the second largest electric and gas distributor, with about 6.6 million customers in three states.

There have not been any new major merger announcements made since the Exelon/Constellation announcement in April 2011, which we believe reflects both the reduced number of potential mergers out there, as well as a "wait and see" attitude utilities are taking towards regulatory approval. We will probably see more companies deciding to acquire certain assets such as power plants or wind farms from other companies rather than attempting to acquire or merge with them.

In April 2012, one month after Exelon closed on its merger, Northeast Utilities completed its merger with NSTAR. The companies reached agreements with regulators in Connecticut and Massachusetts for distribution rate freezes and significant rate credits for customers. Despite the costs, the merger is expected to create to significant growth opportunities through the expansion of its transmission operations.

The most recently completed merger, which closed on July 2, was between Duke Energy and Progress Energy. Final approval for the merger was been delayed when the Federal Energy Regulatory Commission rejected two earlier proposals the companies had filed, citing concern the combined company would have excessive market power. Ultimately, the merger won federal and state approvals and the company became the largest regulated utility in the U.S., with about 7.1 million electric customers in six states.

However, Duke Energy announced almost as soon as the merger had been completed that its board had removed William Johnson, the former chairman, president, and CEO of Progress Energy, as its new president and CEO and that James E. Rogers, would retain his positions as president and CEO. Since it had been assumed from the original announcement of the merger that Mr. Johnson would take on the agreed-to positions, there were heated accusations that Duke's management had deceived Progress Energy management as well as the regulatory commissions.

Duke's action, we believe, will make smaller utilities more wary about being acquired by larger companies, if agreements reached about their position in the merged company can be simply overturned by the board of the acquiring company. It won't kill future merger agreements, but it will probably result in the acquired companies more aggressively seeking legally binding guarantees and/or compensations regarding post-acquisition planning. ■

UTILITY STOCKS

COMPANY / TICKER	‡STARS	‡QUALITY RANKING	*RISK	STYLE	CURRENT PRICE	12-MONTH TARGET PRICE	†P/E RATIO	YIELD %
Duke Energy / DUK	3	B	Low	Value	66	69	15.3	4.5
Exelon / EXC	4	B+	Low	Blend	37	43	13.6	5.7
FirstEnergy / FE	3	A-	Low	Blend	46	46	13.8	4.8
Northeast Utilities / NU	3	B+	Low	Blend	37	39	16.2	3.7
PPL / PPL	4	B+	Medium	Blend	29	32	12.0	5.0

*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. Specific risks to each stock recommendation and target price can be found in each company's individual stock report. ‡See definitions on page 2. †Based on S&P estimated fiscal 2012 earnings. Source: S&P Capital IQ.

Rational Resilience

Alec Young
S&P Capital IQ
Global Equity Strategist

The European Central Bank has a credible plan for region's debt crisis, we believe.

Twists in the European Union's debt drama have been the main driver of international equity performance recently. Since the European Central Bank (ECB) endorsed what we consider a credible crisis fighting roadmap in late July, liquidity bets have helped push both developed international and emerging market (EM) equities to three-month highs. Developed foreign stocks are now up 5% for the year to date, while EM equities have risen about 6%, both trailing the S&P 500's 12.7% gain.

Deteriorating Chinese growth has raised concern the People's Bank of China will be forced to accelerate its easing campaign. Adding fuel to the fire, central banks in the U.S., Japan, the U.K., Brazil, India, Korea, and Turkey, to name but a few, are all engaged in varying degrees of policy easing. With significant economic and earnings erosion already priced in during the spring swoon, it makes sense to us that investors are now looking past the currently weak fundamentals and focusing instead on the potential benefits of future policy accommodation. After all, markets are forward looking.

Even if it takes longer than many have hoped, ECB President Mario Draghi has introduced what we see as a credible roadmap to diffusing the debt crisis. While political hurdles remain, we don't see them as likely deal breakers.

Here's what you need to know: Spain and other troubled EU nations must officially ask the EU bailout fund (the European Stability Mechanism or ESM) to buy their debt in the primary market (i.e. direct sovereign auctions) in exchange for committing to stricter fiscal policies. If this occurs, the ECB has agreed to buy short-term peripheral sovereign debt in the secondary market to reduce borrowing costs and buy time. Adding to investor confidence, private sector bond holders will not be subordinated to the ECB in the event of a default. That was the case with past ECB bond purchases, which diluted their effectiveness by scaring away private investors.

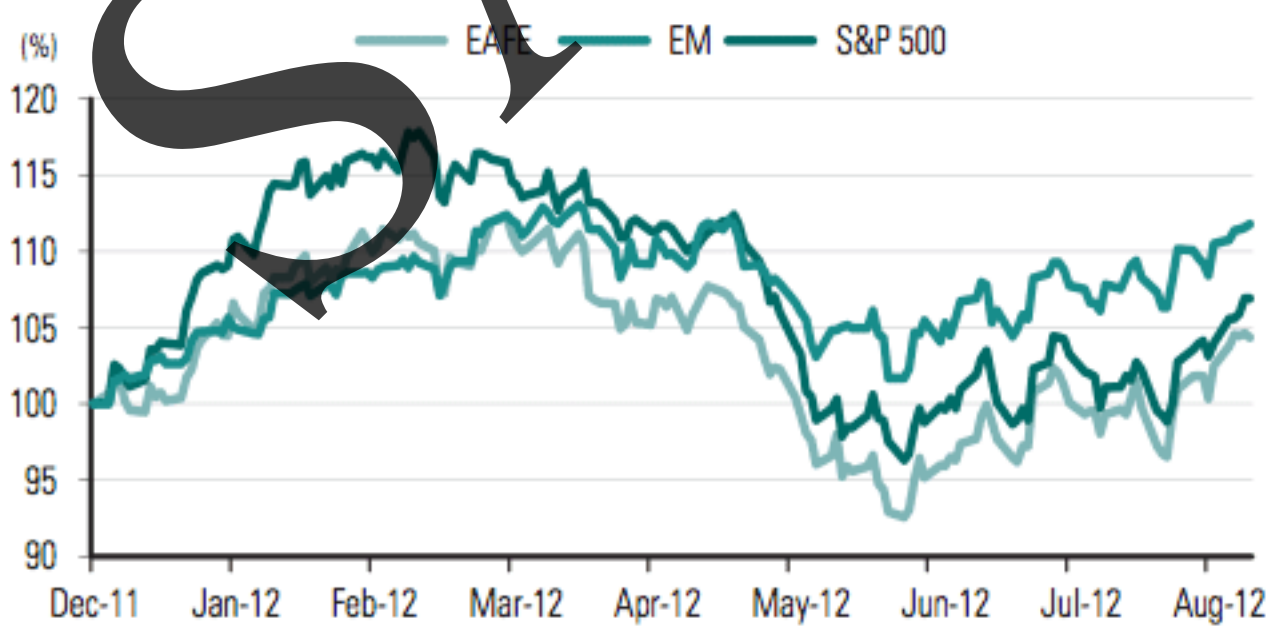
Markets are hopeful Germany and other reluctant, wealthier Northern nations will accept this compromise as a better, if imperfect, alternative to the volatile status quo. The September 12 German Constitutional court approval of the ESM is key, in our view. So is the September Dutch election, where markets want to see a moderate, pro-compromise party elected.

Turning to Asia, while China's July data showed exports rising only 1% year over year, we see investors taking it in stride in anticipation of more aggressive fiscal and monetary stimulus. In addition, Europe is responsible for much of China's latest export weakness and we see the ECB's recent moves to calm markets also offering hope on that front as well.

We favor the consumer staples and health care sectors in both the developed overseas and EM asset classes. While these defensive sectors are best known for limiting drawdown when volatility spikes, investors assume this comes at the cost of tepid gains in up markets. However, that hasn't been true in 2012. After falling less than the market during the brutal spring swoon, both consumer staples and health care are up a healthy 12.1% and 13.9%, respectively, since the June 4 low, vs. a 12.7% gain for the MSCI EAFE Index.

At the country level, we favor the U.K., which has outperformed EAFE by 1.8%, generating a total return of 9.1% vs. 7.3% for the broader benchmark. We believe its 3.8% yield explains some of the outperformance as does a defensive sector mix, a reasonable valuation of only 11-times estimated 2012 earnings per share (vs. 12 for EAFE), a AAA sovereign credit rating, and a strong currency. ■

GLOBAL EQUITIES REBOUND; U.S. OUTPERFORMS



Source: S&P Dow Jones Indices, MSCI (through 8/10 in USD).

Auto Part Retailers Cash In as Vehicles Age

Brian J. Egli
S&P Capital IQ
Editorial

With more older cars on the road, we see rising demand for auto parts.

Driven by a soft economy and the availability of better built models, U.S. motorists are holding onto their vehicles longer, research shows. This trend has been under way for a few years now and should benefit companies involved in the automotive aftermarket and repairs, S&P Capital IQ believes.

The average age of cars and light trucks in operation rose to 10.8 years in 2011 from 9.8 years in 2007 (pre-recession), reports Polk, a provider of auto industry information, whose data shows a steady year-over-year climb during this four-year period.

More recently, a first-quarter 2012 analysis by Experian Automotive shows the average age of vehicles in operation has reached 11 years, up 1.9% from a year ago. In the first quarter of 2012, there were 17.3 million more light-duty vehicles aged seven years and older on the road than there were three years ago, Experian says. The most prominent makes were Ford (F 10 ★★★★), followed by General Motors' (GM 22 ★★★★) Chevrolet, Toyota (TM 83 ★★★★), and Honda (HMC 33 ★★★).

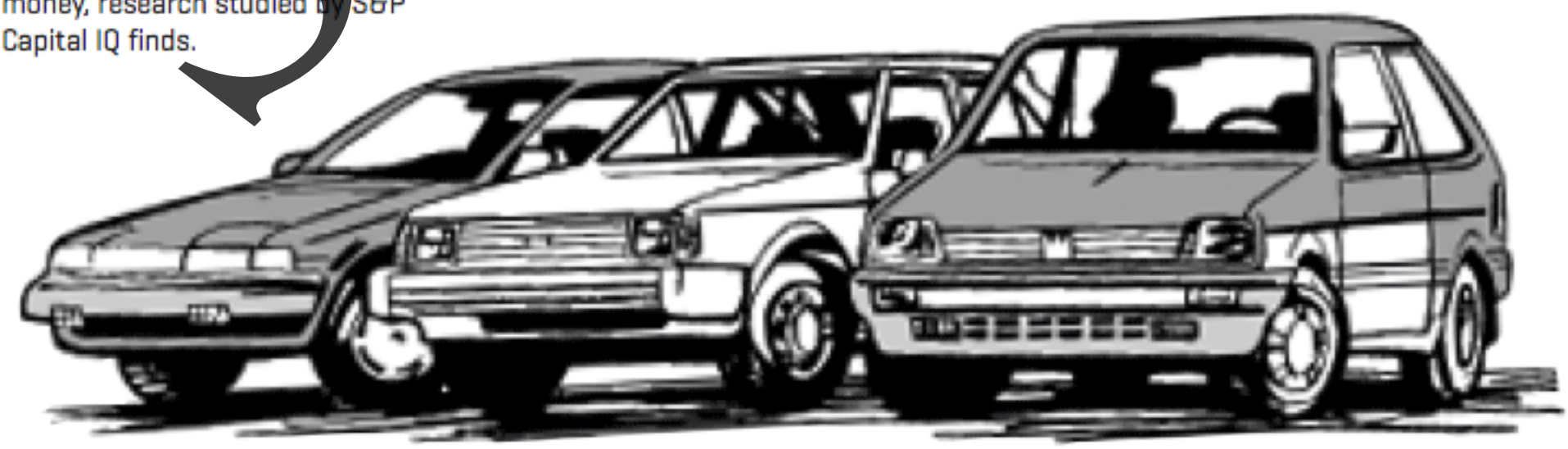
The advancing age of vehicles on the road also reflects motorists becoming more vigilant about service and repairs caused by a desire to save money, research studied by S&P Capital IQ finds.

NPD Group reports that consumers are keeping their cars longer even as new car sales are rising. "The reality is that while new car sales increased in 2011, they remained well below pre-recession sales rates and as a result, aging vehicles still gained influence in the market. Even more robust new car sales would not displace the aging vehicle predominance in a single year," says David Portalatin, an analyst at NPD. "In response to our 2012 Aftermarket Outlook Survey, consumers reported that they expect to keep their current vehicle another five years on average, which would mean the demand for the parts consumers need to keep older cars going strong will maintain momentum in 2012."

"The average age of vehicles on the road is the number-one driver of vehicular maintenance," says S&P Capital IQ Equity Analyst Michael Souers. "Miles driven is the second most important driver, and cars that are seven years or older tend to require significantly more maintenance than newer vehicles."

S&P Capital IQ has a positive 12-month fundamental outlook for auto part retailers, reflecting the aging vehicle fleet, a high percentage of light trucks and sport utility vehicles on the road which typically generate more aftermarket purchases, and a recent uptick in miles driven. Within the group, Souers has buy recommendations on Advance Auto Parts (AAP 73 ★★★★) and O'Reilly Automotive (ORLY 88 ★★★★). He favors the relatively non-cyclical nature of the industry, particularly with weak economic growth in the U.S. While purchases of auto parts are discretionary to some degree, as consumers can put off maintenance for several months or sometimes even years, these repairs typically need to be made at some point to keep the cars running.

Another beneficiary of the aging vehicle trend is TRW (TRW 44 ★★★★★), says S&P Capital IQ Equity Analyst Efraim Levy. While TRW gets more than 80% of revenue from sales to vehicle manufacturers, the aftermarket is still an important business. "Even though new vehicle quality has improved dramatically, as vehicles age many parts may need replacing. Items such as suspension arms and break pads wear out more frequently than some other parts, offering replacement market sales opportunities." ■



Focus Stock: Baidu

Owner of the most visited website in China.

Scott Kessler
S&P Capital IQ
Equity Analyst

The Focus Stock for the week ending August 22 is Baidu, whose American depositary shares (ADSs) carry S&P Capital IQ's highest investment recommendation of 5-STARS or strong buy.

Baidu is the leading provider of Chinese Internet search services and we see considerable growth ahead. In particular, we believe China's Internet population, already the largest in the world, is growing in size and sophistication. That should drive growth in customers, revenues, and profits for Baidu, in our view. While we see Baidu as having stiff competition from other large Internet companies and challenges related to mobile, we believe it is positioned well and operating effectively.

As of August 2012, Baidu.com was the most visited website in China and the fifth-most trafficked website around the world, according to traffic ranking website Alexa.com, behind only the primary websites of Google (GOOG 676 ★★★), Facebook (FB 19 ★★★★), YouTube and Yahoo (YHOO 15 ★★★★★). Interestingly, many or most offerings from Google, Facebook, and YouTube are not accessible in China.

It provided online marketing services to 352,000 active customers in the second quarter of 2012. In light of the global macroeconomic slowdown that is affecting China, Baidu has focused increasingly on small and medium-sized business.

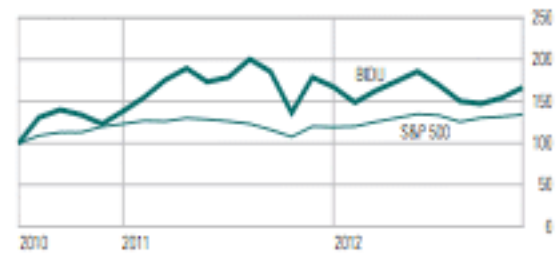
Baidu has developed and provides dozens of mostly consumer-focused products and services. The company is probably best known for Baidu Web Search, though it also operates online directories, social networking products, user-generated knowledge products, location-based offerings and a wide range of other online products.

China's 513 million online users exceeded the totals of North America, South America and Latin America, combined, and accounted for 23% of the world's Internet population, as of year-end 2011, according to Internet World Stats. Revenue from the Chinese search market rose by 63% in 2011 to $2.9 billion from $1.8 billion (reflecting a recent exchange rate of 6.3619 Chinese renminbi for each U.S. dollar), according to Analysys International. Baidu accounted for 79% of Chinese search revenues in the second quarter of 2012, according to Analysys International. Google ranked second with a 16% share.

From 2007 to 2011, Baidu's profits have increased more than 10-fold.

We project per-ADS profits of $4.83 for 2012, $6.89 for 2013 and $9.24 for 2014. We forecast that revenues will rise 59% in 2012, 44% in 2013 and 38% in 2014, largely driven by growth in the Chinese search segment. We believe margins will decline somewhat over the indicated period, reflecting a less favorable revenue mix, owing in part to a greater amount of mobile advertising offerings, and significant investment in a number of growth initiatives.

BAIDU



Ticker: BIDU

S&P Ranking: ★★★★★

Current Price: 134

12-Month Target Price: 180

Market Cap: $35.4 billion

Investment Style: Large Cap

Source: S&P Capital IQ.

Baidu currently trades at 27-times our 2012 per-ADS profit estimate of $4.83. We see three-year compound annual growth in per-ADS earnings of 45%, leading to a P/E-to-growth (PEG) ratio of 0.6. We note that the shares' indicated P/E is below our projected growth rates for revenues and earnings.

We employ relative P/E and P/E-to-growth analysis involving both major Chinese Internet companies listed on U.S. exchanges, and Google, to value Baidu. Based on Capital IQ data, the peer group of nine Chinese companies we used had an average 2012 P/E of 20 and PEG ratio of 1.6. Applying these multiples to Baidu and averaging the results, its share price would be around $200. Meanwhile, Google recently had a 2012 P/E of 17 and PEG ratio of 1.0. Assuming Baidu traded at comparable multiples, and averaging the results, it would be valued at around $150. Blending the inputs related to Google and the Chinese Internet company peer group results in our 12-month target price of $180.

Our $180 target price implies a 2012 P/E of 37 and PEG ratio of 0.8 and a 2013 P/E of 26 and PEG ratio of 0.6.

We think that Baidu has a relatively straight-forward business model, but a complicated corporate ownership structure. Despite being based in and operating primarily in China, Baidu was incorporated in the Cayman Islands. Baidu owns Baidu Holdings, an entity based in the British Virgin Islands, that owns or has majority stakes in subsidiaries incorporated across multiple jurisdictions from China and Hong Kong to the Cayman Islands and the U.S. The company also controls multiple variable interest entities and this structure has been questioned by Chinese regulators over the relatively recent past.

(Continued on page 7)

Top-Ranked Dividend Payers

Isabelle Sender
S&P Capital IQ
Editorial

Stocks with a low P/E, dividend, and strong buy recommendation.

For investors who believe U.S. equity valuations are unduly depressed, there are several stocks that carry S&P Capital top ranking of 5 STARS or strong buy that trade significantly below current and historical benchmark valuations and also offer attractive yields.

Currently, valuations appear attractive when compared to historical data. As of the S&P 500's August 10 close, the large-cap benchmark was trading at a price-to-earnings (P/E) multiple 13.6 times S&P Capital IQ equity analysts' earnings per share estimates for 2012, while the S&P 1500 Composite 1500's P/E was 14.1.

Historically, the median P/E for the 500's operating results since 1988 is 17.9 times and 15.7 times for earnings reported under generally accepted accounting principles (GAAP) since 1936.

S&P Capital IQ Chief Equity Strategist Sam Stovall's interpretation of S&P 500 history and technical indicators suggests the market has a good chance of extending its current rally. He believes the S&P 500 "could rise to between 1450 and 1500+ by the end of 2012."

This week's stock screen shows 10 U.S.-traded companies ranked 5-STARS (strong buy) with a P/E ratio equal to or less than 10, and a dividend yield higher than 2%. ■

STOCK SCREEN OF THE WEEK

COMPANY / TICKER	‡QUALITY RANKING	*RISK	STYLE	CURRENT PRICE	12-MONTH TARGET PRICE	†P/E RATIO	YIELD %
Aflac / AFL	A-	Low	Growth	46	53	7.1	2.9
Barrick Gold / ABX	B	Medium	Foreign	36	52	8.2	2.2
• Chevron / CVX	A+	Low	Blend	119	132	8.3	3.2
Hunt. Bancshares / HBAN	B-	Medium	Blend	6	8	8.8	2.7
Johnson Controls / JCI	A	Medium	Blend	27	38	10.0	2.7
Magna International / MGA	B	Medium	Foreign	45	57	8.3	2.4
• Microsoft / MSFT	A-	Medium	Growth	31	37	9.9	2.6
Rio Tinto / RIO	NR	Medium	Foreign	48	63	6.9	3.5
Travelers / TRV	B+	Medium	Value	64	75	10.0	2.9
Valero Energy / VLO	B	Low	Blend	29	35	7.6	2.4

• Master List issue. *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. Specific risks to each stock recommendation and target price can be found in each company's individual stock report. ‡See definitions on page 2. †Based on S&P estimated fiscal 2012 earnings. Source: S&P Capital IQ.

Focus Stock: Baidu *(Continued from page 6)*

Reflecting the company being incorporated in the Cayman Islands, the company does not have to hold annual shareholder meetings. In fact, Baidu did not conduct such a meeting in 2011.

We see a number of investment risks related to our recommendation and target price. The company is based in and operates in China, and we view government entities as having considerable oversight of and control over the company and its offerings. Additionally, the company's significant market share, influence, and success could make actions from government agencies more likely. Also, we believe Baidu's complicated ownership structure could be subject to review. If this structure changed, it could result in a higher corporate tax rate and lower profitability.

In light of indications about challenges some Internet companies are having with monetization of consumer mobile content and applications, we wonder to what extent Baidu could experience related difficulties. Baidu has acknowledged that mobile content, applications and activity can be difficult to monetize and it does not plan to rush to come up with solutions.

We see competitive threats from large and well-capitalized Internet companies. As mentioned earlier, Sohu and Tencent are Chinese companies with competing search offerings. Alibaba Group and Sina are large Chinese companies with strong franchises in Internet areas outside search that could leverage their positions and assets to pursue search offerings. Non-U.S. companies like Google could also look to strengthen their presence in the search market and related areas.

We see Baidu as an attractively positioned leader at the heart of China's Internet. We believe the company has prepared and invested effectively as users increasingly employ wireless devices and tablets to conduct searches, consume content and interact with applications. In our view, the company offers significant growth potential, a strong balance sheet, and a compelling valuation. Despite some risks, we see Baidu as a franchise Internet holding. ■

FUND STRATEGIES

Baird Core Plus Bond Fund

Isabelle Sender
S&P Capital IQ
Editorial

A management team working together for the past 33 years.

The team managing Baird Advisors' Baird Core Plus Bond Fund could be the most experienced fixed-income portfolio managers in history, says Warren Pierson, a senior portfolio manager for the fund. He doesn't know of any other bond team that has been working together as long as his.

"We're a seasoned team, the core of which has been working together for 33 years," Pierson says, and he believes their long tenure is valued by the fund's investors. The average client relationship the team manages exceeds 14 years, predating the fund's launch in 2000.

The relatively long tenure of the fund's management team garners a favorable grade by S&P Capital IQ for risk considerations. S&P Capital IQ gives a stronger ranking to funds whose managers have long tenures because the same managers tend to keep the same investment strategies.

"We believe experience and longevity of the team are how our clients win over the long term," he says. Pierson believes an efficient bond portfolio is one that doesn't have a lot of turnover. "We're very opinionated about each bond that's in the portfolio," he says.

Security selection is key, Pierson says. The team has a bottom-up strategy and spends the vast majority of its time conducting "credit research security-by-security and sector-by-sector."

The team focuses on risk control and understanding the benchmark, he says, and that means no derivatives, no emerging-market debt, and no foreign currency denominations.

Pierson thinks rival funds with "plus" in their name may choose to go beyond a portfolio's stated plan. The "plus" in the Baird Core Plus Bond Fund team's strategy represents "a slice of high yield," he says.

While taking on the added risk of sub-investment grade debt, Pierson says the team is also underweighting what he feels are some of the riskiest bonds in the market: U.S. Treasuries. The Federal Reserve has stated that it believes "economic conditions — including low rates of resource utilization and a subdued outlook for inflation over the medium run — are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014." Once the Fed begins to raise rates, however, Treasuries may begin to slide.

According to Pierson, the team has well-diversified holdings among those issuers rated speculative or "junk," focusing on select fixed-rate non-agency mortgage securities and corporate "fallen angels" — bonds that were once investment grade but have lost that rating. He adds that team members believe there is also currently good value among short-duration BBB-rated corporate debt.

"It all starts with risk control and we ask ourselves what can go wrong with this bond or sector, and how bad it could get. But that's where experience plays a part as we see a range of possibilities that we can draw from our experience," he says.

Perhaps one surprise for the group was its successful investment in the financials sector, in which the fund is overweight its benchmark. ■

BAIRD CORE PLUS BOND FUND

Ticker: BCOSX

S&P Ranking: ★★★★★

Current Price: $12

Total Net Assets: $700 million

Asset Class/Region/Type:
Taxable Fixed Income/Domestic/Medium Term

12-Month Total Return: 6.3

3-Year Total Return (Average Annualized): 9.1

Inception Date: 9/29/2000

Gross Expense Ratio: 0.55

Data through 8/16/12.
*Total returns include reinvested dividends and capital gains, all annualized; calculations do not reflect the effect of sales charges.
Sources: S&P Capital IQ.

ETF STRATEGIES

High Yielding Dividend ETFs

Art Epstein
S&P Capital IQ
Editorial

Three of the highest yielding domestic equity ETFs.

With a weak global economy dampening the climate for new investment and expansion, more S&P 500 companies have begun paying dividends or are raising them. This couldn't come at a better time for income seeking investors, since the yields on most fixed income securities are near record lows. Exchange traded funds (ETFs) offer a convenient way to gain exposure to these stocks, we believe.

For the year through August 7, 2012, 13 S&P 500 companies initiated regular cash dividend payments, bringing the total to 402. There haven't been as many dividend payers in the S&P 500 since December 1999, says Howard Silverblatt, senior index analyst at S&P Dow Jones Indices (which operates independently of S&P Capital IQ). So far this year, 226 S&P 500 companies have raised their dividends, Silverblatt says, and he expects that by the end of 2012, about 70% of S&P 500 members will have raised their dividends from 2011.

In 2011, S&P 500 companies paid a total of $241 billion in dividends, up 23% from the $196 billion paid in 2009 when the last recession ended. Silverblatt sees S&P 500 dividends totaling about $275 billion this year, which would beat the record of $248 billion paid in 2008.

"The growing trend of companies paying and increasing their dividends is the direct result of a slowly improving economy, record earnings and cash flow, as well as a growing appetite from investors for income producing investments," Silverblatt says. "We would expect additional buying pressure on dividend type instruments as the baby-boomers move away from growth and focus on more secure income flows."

Investors turning away from risk and toward income may want to investigate the following dividend ETFs, all with the highest "overweight" ranking from S&P Capital IQ.

For real yield, utilities are the way to go. According to MarketScope Advisor data, the highest yielding ETF among domestic equity ETFs with an overweight ranking is the Utilities Select Sector SPDR Fund, which currently pays about 3.68%. The fund owns 31 individual names, essentially all the utility stocks in the S&P 500. As of August 15 it had just shy of $5 billion in assets. Duke Energy was its largest holding, at 9.5% of assets, followed by Southern Co. at 8.8% and Exelon at 7%. S&P Capital IQ Equity Analyst Justin McCann has a neutral 12-month fundamental outlook for the electric utilities group, the largest part of the utilities sector.

The second highest yielding ETF among domestic equity ETFs ranked overweight is the iShares Morningstar Large Value Index Fund. This fund is much smaller in size, with about $250 million in assets, and more diversified, with 83 individual holdings. Energy is its largest sector exposure, with about 28% of assets as of August 15 and Exxon Mobil its largest holding, at 11.6% of assets. Chevron, General Electric, and AT&T all account for more than 5% of assets.

The Vanguard High Dividend Yield Index Fund is the third highest yielding ETF among domestic equity funds ranked overweight, with a recent yield of 2.81%. Also available as a mutual fund, this fund "provides broad exposure to U.S. companies that are dedicated to consistently paying larger-than-average dividends," Vanguard says. It has $5.2 billion in assets spread across 436 names, with Exxon Mobil, Microsoft, and General Electric its three largest holdings. ■

POSITIVE POTENTIAL IMPLICATIONS

FUND NAME / TICKER	S&P RANKING	*TOTAL RETURN YTD	1-YEAR	3-YEAR	5-YEAR	CURRENT PRICE	EXPENSE RATIO
iShares Morningstar Large Value Index / JKF	OW	10.7	17.7	11.4	-1.9	64	0.25
Utilities Select Sector SPDR Fund / XLU	OW	5.3	18.2	13.1	3.4	37	0.18
Vanguard High Dividend Yield Index / VYM	OW	12.1	24.3	15.8	2.6	50	0.13

Data through 8/16/12. *Total returns include reinvested dividends and capital gains, all annualized; calculations do not reflect the effect of sales charges. OW-Overweight. Source: S&P Capital IQ.

Portfolio Focus: Oneok Invests Heavily In Bakken

Brian J. Egli
S&P Capital IQ
Editorial

Oneok, an Oklahoma-based diversified energy company, joined the High Quality Capital Appreciation Portfolio on June 23. The company has three businesses: it operates the largest natural gas distribution utility in Kansas and Oklahoma, its Energy Services division markets natural gas to other gas distribution utilities, and it is the general partner and 43% owner of Oneoke Partners (OKS 56 ★★★★), a limited partnership that owns an extensive natural gas gathering and transportation pipeline network.

Through its Oneok Partners interest, Oneok is gaining exposure to the Bakken shale play, an exciting new area of oil production located mostly in North Dakota that has made that state the fourth largest onshore oil producer in the U.S., behind Texas, Alaska, and California.

Oneok isn't among those producing oil and gas in North Dakota, but it is investing billions of dollars to build pipelines that will bring those products to market.

"With the strong development of oil wells in the Bakken shale region, there is a strong need to transport the oil and natural gas products to market," says S&P Capital IQ Equity Analyst Christopher Muir, who includes OKE in his coverage universe.

Tanjila Shafi, an S&P Capital equity analyst who covers OKS among other oil and gas storage and transportation securities, notes OKS has earmarked $3.6 billion to $4.2 billion for projects in the Bakken shale region. Those projects include the $450 million to $550 million Bakken Pipeline project, a 525 mile pipeline connecting natural gas liquids gathering systems in the Bakken to the interstate pipeline system. It is also building three natural gas processing plants in the region and the Bakken Crude Express Pipeline, a 1,300 mile pipeline transporting oil produced in the Bakken to the U.S. oil distribution hub in Cushing, OK.

"We see OKS' $5.7 billion-$6.6 billion in planned growth spending as driving EPS and cash flow growth for OKE," says Muir. "OKE's investment in OKS yields steadily growing cash flows in the form of common unit distributions and general partnership distributions, which include bonus distributions to the general partner based on the level of distributions to common units," Muir adds. ■

MASTER LIST UPDATE: HIGH-QUALITY CAPITAL APPRECIATION PORTFOLIO

COMPANY / TICKER	‡STARS	‡QUALITY RANKING	*RISK	STYLE	CURRENT PRICE	12-MONTH TARGET PRICE	†P/E RATIO	YIELD (%)
American Express / AXP	5	A-	Medium	Growth	57	72	12.6	1.4
Apache / APA	5	A-	Medium	Blend	89	116	9.5	0.8
Automatic Data Processing / ADP	4	A	Medium	Growth	58	63	20.1	2.7
C.H. Robinson Worldwide / CHRW	4	A+	Low	Growth	57	76	20.9	2.3
Cummins / CMI	5	A-	Medium	Value	103	125	10.8	1.9
CVS Caremark / CVS	5	A+	Low	Blend	45	56	13.3	1.4
Disney (Walt) / DIS	5	A+	Medium	Growth	50	55	16.0	1.2
Express Scripts / ESRX	5	A-	Medium	Growth	61	70	16.4	Nil
Fastenal / FAST	5	A	Medium	Growth	43	60	28.7	1.8
Hess / HES	4	A-	Medium	Blend	50	58	8.8	0.8
Int'l Business Machines / IBM	4	A+	Low	Growth	201	227	13.3	1.7
McKesson / MCK	5	A-	Low	Blend	89	107	12.2	0.9
Mylan / MYL	4	A-	Medium	Growth	24	27	9.6	Nil
Oneok / OKE	5	A-	Low	Value	45	50	25.1	2.9
Target / TGT	5	A+	Low	Growth	64	78	14.9	2.3

Performance: Year-to-date as of 8/10/12, the Portfolio gained 13.4% vs. an increase of 11.8% for the S&P 500. *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. †Price/earnings ratios are based on S&P estimated fiscal 2012 per-share earnings. ‡See definitions on page 2. 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.

Top Ten Portfolio

This dynamic, actively managed portfolio has outperformed the S&P 500 since inception.

The Top Ten Portfolio comprises stocks that S&P Capital IQ believes to be well positioned for solid capital appreciation over the next 12 months.

Stocks must have a five-STARS ranking to enter the portfolio. If the ranking drops below four STARS, the stock will be removed. In addition, any stock in the portfolio may be replaced with a five-STARS stock at any time. All of the stocks in the portfolio, except American Tower, General Mills and International Business Machines, are currently ranked five STARS.

The goal of the Top Ten Portfolio is to outperform the S&P 500 index on a capital appreciation basis. S&P Capital IQ's Senior Portfolio Group, a subcommittee of our Investment Policy Committee, selects the stocks. The intention of the portfolio is to be fairly balanced among economic sectors.

The goal of the Top Ten Portfolio is to outperform the S&P 500 index on a capital appreciation basis.

The portfolio currently has nine large-cap stocks and one small-cap issue. It has three stocks from the consumer staples sector, two issues from information technology, and one stock each from the financials, consumer discretionary, industrials, materials, and energy sectors. The best-performing stock in the portfolio this year through August 10 was Neenah Paper (+18.8%). The worst-performing stock was Coach (-10.2%).

This focused portfolio was launched on December 31, 2001. This year through August 10, the portfolio rose 10.0%, while the S&P 500 climbed 11.8%. Since inception through August 10, 2012, the portfolio gained 2.4% (annualized) vs. a 1.9% increase for the S&P 500.

Readers should note that past performance is no guarantee of future results. ■

TOP TEN PORTFOLIO

COMPANY / TICKER	‡QUALITY RANKING	*RISK	STYLE	†P/E RATIO	CURRENT PRICE	12-MONTH TARGET PRICE	FUNDAMENTAL SNAPSHOT
American Tower / AMT	B	Medium	Blend	45.5	71	82	We expect a 14% revenue increase in 2012
Coach / COH	B+	Medium	Growth	14.7	57	70	Number one luxury accessories brand in the U.S.
• Coca-Cola / KO	A+	Low	Growth	19.9	40	44	World's largest producer of soft drinks
FedEx / FDX	B+	Low	Growth	13.6	90	122	Provider of air express and ground delivery logistics
General Mills / GIS	A	Low	Blend	14.2	38	42	International expansion should be a long-term growth driver
• Int'l Business Machines / IBM	A+	Medium	Growth	13.3	201	227	We value the company's well-diversified offerings
Neenah Paper / NP	NR	High	Value	10.2	28	36	A global manufacturer of fine and specialty paper
Philip Morris Int'l / PM	NR	Low	Blend	17.8	93	102	The largest publicly traded tobacco company
Qualcomm / QCOM	B+	Medium	Growth	21.0	63	78	Designer of mobile communication technology chipsets
Valero Energy / VLO	B	Low	Blend	7.6	29	35	Well positioned to benefit from increased global demand

• Master List issue. *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. †Based on S&P estimated fiscal 2012 earnings. ‡See definitions on page 2. Source: S&P Capital IQ.

THE OUTLOOK
INTELLIGENCE FOR THE INDIVIDUAL INVESTOR

The Observatory

Selected actions for August 10 through August 16.

NAME	SYMBOL	CURRENT PRICE ($)	NEW STARS	OLD STARS	STARS CHANGE DATE	QUALITY RANK
Cisco Systems	CSCO	19	4	3	8/16/12	B+
Darden Restaurants	DRI	53	4	3	8/15/12	A
Deere	DE	75	3	4	8/15/12	A
Dell	DELL	12	3	4	8/15/12	B+
Dollar Tree	DLTR	48	3	2	8/16/12	B+
Facebook	FB	20	4	3	8/14/12	NR
Ntelos Holdings	NTLS	17	4	3	8/15/12	NR
NYSE Euronext	NYX	26	4	3	8/14/12	NR
PetSmart	PETM	70	3	4	8/16/12	A
PS Business Parks	PSB	68	4	3	8/14/12	B+
TJX	TJX	45	4	3	8/14/12	A+

Source: S&P Capital IQ.

For daily STARS changes, subscribers can call *The Outlook* hotline, 800-818-7827, 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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The 7% Solution *(Continued from cover)*

"The U.S. economy has been showing signs of improvement and worries over a Lehman-like fallout from Europe have dissipated," says S&P Capital IQ Chief Equity Strategist Sam Stovall. "We are encouraged that the U.S. economy may be slowly recovering on its own, and see increased stability from one less wobbly leg on the global economic stool."

Earnings for S&P 500 companies have proven surprisingly resilient in the face of a global economic slowdown during the first half of 2012. S&P Capital IQ consensus earnings per share estimates predicted earlier this year that just three of the S&P 500's 10 economic sectors would report profit growth at all in the second quarter; now six sectors are estimated to have advanced. Industrials are seen posting the strongest gains, followed by information technology and health care.

Almost 70% of companies reporting have delivered profits above consensus estimates, more than the 10-year average of 62%. Estimates now call for a modest, but not negative, 4.14% earnings per share gain for all of 2012, with earnings growth accelerating markedly in the fourth quarter. In 2013, consensus estimates currently call for a fairly robust 11.7% rise in S&P 500 earnings per share, led by more than 20% advances in the materials and telecommunication services sectors as well as double digit gains for the consumer discretionary, information technology, industrials, and financials sectors.

Every major equity market in the world, except Spain, is in positive territory for the year, and with the outlook for growth improving, some strategists are even questioning whether the Federal Reserve will feel the need for further stimulus measures. While the ECB's plan has the market's attention for now, stronger global growth would be the real 7% solution. ■

—*Vaughan Scully*
S&P Capital IQ Editorial