

**IN THIS ISSUE:****EUROZONE:** Svenska Cellulosa AB -- Selling Diapers to the Developing World; News and Rumours**N. AMERICA:** Xerox Continues to Impress Through ACS Honeymoon; CAT, 3M, Royal Caribbean Underscore Traction, News and Rumors**DATA ROOM:** CDS and Bond Sector Averages/Z-Scores; Biggest Movers and Market Breadth**EUROZONE****SVENSKA CELLULOSA AB****Selling Diapers to the Developing World**

SCACAP was formed in 1929 when the forestry assets of Svenska Handelsbanken were partitioned from the banking firm. Since then the company have grown their brand highly visible under its SCA label.

SCACAP competes against the main paper manufacturing companies in Europe (i.e. against UPM Kymmene, Norske Skogindustrier and Stora Enso); in packaging it competes most prominently against Smurfit kappa Group Plc.

SCACAP are a freely listed Company with a total of 30% of the voting rights controlled by Industrivarden AB, its largest shareholders.

**Earnings**

In its earnings yesterday SCACAP reported a 2Q sales reduction of 3% to SKr 54.374Bn on a CER basis (net sales increased by 4% - i.e. non-CER). This produced a profit up 10% at SKr 2.86Bn beating expectations.

In **Personal Care** sales fell 5% during 1H10 to SKr 12.5Bn, operating margin reported at 11.9% for the period; in **Tissue products**, sales fell by 5% during 1H10 to 19.8Bn, producing an operating profit down 20% to SKr 1.5Bn and relatively weak 7.6% operating margin; **Packaging** reported 1H10 sales up 3% to SKr 14.84Bn on a net basis producing an operating profit of SKr 498M and weak 3.4% operating margin.

During 2Q10 working capital increased as a result of higher account receivables and higher raw material costs (boosting inventory comparables). This detracted SKr 1.77Bn from cash flow; CFO for the credit was SKr 2.82Bn (strongly down from the prior SKr 4.68Bn comparable). SCACAP also booked SKr 327M (on an after tax basis) against restructuring costs. Tax payments were also heavy detracting from cash flow productivity at SKr 798M vs. 204M in 2Q09.

The firm is starting to see a return to consumption of some of the most cyclical products with magazine paper (SC and LWC) up 6% and more importantly corrugated board products up 7% into May this year, corrugated board products up from their trough one year previously. Whilst demand for SC and LWC paper grades rose during 1H10, we believe this is too much to hope for further increases during the remainder of this year.

**Business Description**

SCACAP are a leading hygiene (including feminine hygiene), baby diaper, incontinence, paper and packaging product manufacturer. The firm has a degree of vertical integration with forest and sawn timber operations (indicated by S&P at 44% of virgin fibre requirements, along with 27% recycled fibres). These help it offset raw materials costs and the main reason for price inflation effects over the last 18 months not feeding through to profitability. Recycled paper for instance has increase by more than 70% recently; European price rises are even more inflationary with price rises up 120% according to the firm.

The bulk of this company's sales are European based (~78%) with little being made abroad to the US at ~10%. The group therefore cater for the developed markets of Western Europe and experience the cyclical dynamics associated with Forest products and packaging in that geographical location.

In **Personal Care** the company is the market leader in incontinence products through Tena; in baby diapers, it has achieved a market share of 60% in Nordic countries with its Libero and occupies strong markets in tampons through Libress.

In **Tissue products** the firm is a leader in consumer tissue products, this unit divides itself into consumer tissues and away from home. Currently it is experiencing strong EM sales growth.

In **Packaging** (the weakest margin unit of the firm), where it is less than half the size of the EU market leader Smurfit kappa Group Plc. This is and we believe will always be a competitive marketplace with strongly cyclical prices and relatively low barriers to entry. **Forest Products** are producing one of the better operating margins currently at the group at levels typically above 14% operating margins, this segment at the firm

During F6M10, sales for the firm have been dominated by Packaging (27%), followed by Tissue products (at 25%), Personal Care (23%) and Forest Products at 16%. Personal Care and Tissue Products are where the margin is, with very little operating profit produced by Packaging by comparison. Personal Care and Tissue products each supplied 32% of operating profit, with Forest products a strong 25% in comparison to Packaging's weak 11% during the last six months.

Despite being at the stronger end of the pulp and paper market this credit is still booking restructuring projects and associated negative costs. Recently it closed a factory in Linselles France associated with the European baby diaper operational improvements. The first quarter of this year saw it booking of EUR 70M costs associated with another plants and cutting of 50 Dutch

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employees. During the first half of this year the company has spend a total of EUR 130M in cash costs in order to produce EUR 60M of savings annually in the future. *We note that the current packaging program target set itself a SKr 1.1Bn savings target out of mid 2010.*

During the period the firm made a disposal of some Asian packaging operations.

**Ratings Considerations: suffering because of its peers**

This credit is rated Baa1/ BBB+ Negative, the negative S&P outlook being assigned just before the worst part of the downturn on 29th October 2008.

The firm have a large set of bilateral lending facilities of ~ SKr 8Bn dwarfing their EUR 2.1Bn set of LT credit facilities. Cash and cash equivalents at SCACAP are currently running at SKr 4Bn, not enough to pay the next twelve months of CP which it has a total of SKr 6.98Bn outstanding; similarly the firm have a total of SKr 8.6Bn due during 2011, thanks in part to the Eurobond we mention below; we believe this indicates a possible return to the marketplace next year. The company net debt figure for 2Q10 is a level of SKr 40.85Bn.

S&P have a relatively negative disposition on this particular credit due to their concerns about development of the packaging markets. In the EU these remain weak, liner price increases out of last year are now hitting its 1H statement. The ratings agency believes there is a strong possibility of imbalances from the addition of extra capacity by peers, with large factories being commissioned in the near term by its competitors. Our belief is that they may easily see this as an alternative to the commoditised, weak demand of paper grades. *The key measure S&P are looking at here is maintenance of an adj. FFO/debt of ~30% in the short term; they note that any major debt financed acquisition creates immediate downside risk for the ratings. However they so allow for a degree of flexibility in capex and similarly expect operating cash flow generation greater than the sum of capex and working capital needs.*

Dividends are paid annually at the company the most recent payment being this quarter's SKr 2.6Bn payment; this was a large 54.6% of last year's net income.

**Technical Considerations**

Our preference for this credit is on a relative value basis against its paper and packaging peers, Stora Enso Oyj Ba2/BB Neg (285/300), UPM Kymmene Ba1/BB (240/260) and Norske Skogindustri (10.5/10.8%). This is because of the standard paper grades these three suppliers sell to the print industries as their main bulk industry product.

This picture is clearer in the long-term credit quality, mostly reflecting leverage evolution of these companies. UPM Kymmene for instance has regressed from BBB+ as of Janu-

ary 2003 to a level that is currently BB; similarly Stora Enso dropped from a BBB+ 2003 level to BB as of 14th May last year; finally Norske Skog has dropped from a BBB \*- as of February 2003 all the way through BBB and BB to a single B ratings, ones we note which are currently awarded a negative outlook.

In comparison SCACAP has only dropped one notch from A- to BBB+ during this period. The key component in this is the paper products that SCACAP are choosing to manufacture: they are not ones that are being by passed through the paper to electronic redundancy, and, as our headline suggest they have inherent growth prospects in their choice of business segmentation.

Presently SCACAP's 5Y CDSs are 84/91; there is almost no term structure in the bond debt for the credit that is liquidly traded even the SCACAP 3.875s 03/11 are now too short to provide any tradeable term structure for its debt. This in our view is a good reason for the CDSs trading at tighter multiples than their Baa1/BBB+ Neg assigned rating would suggest.

Mark Hunwick

## EUROZONE MARKET RECAP

EU credit markets had a stronger day.

iTraxx S13 Indices						
22/07/10						
	5Y			10Y		
	Bid	Ask	Move	Bid	Ask	Move
Europe	114.22	114.59	-0.51	118.60	119.40	-0.21
HiVol	169.92	172.08	-1.40	176.38	179.63	-0.67
Crossover	510.40	513.00	-8.93	493.75	503.75	-8.50
	EU sub-sectors			EU sub-sectors		
Finl Snr	133.83	134.67	-0.25	138.25	140.98	1.45
Finl Sub	211.75	213.75	-1.13	214.50	218.47	0.15
SovX	132.94	133.69	-0.19	127.67	131.00	N/A
<b>Volatilities</b>	<b>Last</b>	<b>High</b>	<b>Low</b>	<b>Change</b>	<b>Prv. Close</b>	
V1X Index	21.65	22.55	21.37	-0.50	22.16	
V2X Index	27.31	28.76	27.15	-1.12	28.43	

**Autos, Auto Parts, Aerospace, Transport and Defence**

**Fiat SpA** is to start manufacturing a new family car (currently called the N zero) at its Serbian plant. The new model will be made in two version with 5 or 7 seats, to compete with the Mercedes Benz A class and the Citroen Picasso or Opel Zafira respectively. EUR 800M is to be invested in production of the plant, EUR 100M more than originally announced.

**PSA Peugeot Citroen** is planning to add an additional 300 employees to the Mangual de Portugal plant out of November according to Jornal de Negocios; the plant has 900 workers presently.

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**Volvo AB** reported 2Q net income beating analyst estimates at SKr 3.15Bn, with net sales of SKr 68.8Bn being achieved or the quarter, the firm experiencing a strong 27% sales rise. The firm reported 2Q operating income of SKr 4.8Bn and a pre-tax profit of SKr 4.54Bn. The firm have given bullish forecasts for Asian and European construction markets with growth levels predicted at 30-40% and 10% respectively, however US contribution markets are only expected to grow 5-10% by comparison.

#### Banks and Financials

**Credit Suisse Group AG** reported a drop in profits at its Investment Banking unit during 2Q10 to report a 3.1% decline in its Swiss trading profits. The firm reported 2Q10 NI up 1.4% to CHF 1.59Bn thanks to tax credits. The firm reported gains of CHF 922M on its own debt. The firm reported a Tier 1 of 16.3%

**Julius Baer Group Ltd** have announced their intention to purchase a traditional private bank in Germany earnings > 80% of revenues from wealth management according to Handelsblatt.

**Swedbank AB** reported a SKr 1.57Bn profit during 2Q, the bank reporting a profit before impairments and excluding items of SKr 2.2Bn. The firm reported 2Q10 Net Commission Income of SKr 2.4Bn, NII of SKr 3.8Bn (down 5.5%). The firm reported **Ektornet** holding an expected set of assets of SKr 4Bn as of YE10. Their Baltic development is likely to be impacted by legislation k however they see Baltic credit lending quality improving.

#### Consumer/Retail/Tobacco

Business India has reported **Coca Cola** recording a 22% surge in Indian sales.

**Imperial Tobacco** reported a 45.5% of the UK cigarette market, but a 9 monthly decline in volumes by 4.3%. The firm also reported Russian and Ukrainian volumes declining.

**Kingfisher Plc sales** have been reporting increasing by 0.3% during the L10wks on a CER basis (0.8% lfl basis). The firm's sales were negatively impacted as it sold less kitchens and bathrooms.

#### Industrials

**ABB Ltd** has reported 2Q NI of USD 623M beating estimates, and a USD 975M EBIT figure equivalent to a 12.9% margin, (down 30bp). The firm reported Power products EBIT of USD 417M, power systems EBIT of USD 18M, Automation of USD 205M, low voltage EBIT of USD 213M and Process systems EBIT of USD 189M. The firm still see strong pricing pressure in energy.

**Eurostar Group Ltd** is preparing to tender to replace part of its London to Paris fleet and has stated interest in **Siemens AG**.

**SSAB** reported 2Q NI up at SKr 369M, from last year's 633M net loss.

**Stora Enso Oyj** reported a 2Q profit of EUR 159.9M, strongly beating analyst expectations.

**Syngenta AG**, have abandoned their 2010 growth targets following ballooning inventories in pesticides and crop care products detracting from pricing. The firm reported net income falling USD 150M to USS 1.25Bn during 1H10, with sales up 1% to USD 6.74Bn. The firm reported crop protection sales of

USD 5Bn, with seed sales stead at USD 1.76Bn. The firm reported price falls of 5% during the period, stating tha tit los > USD 100M due to glyphosate.

#### TMT

**Colt Group SA**, reported 1H profits down 18% to EUR 45.6M. The firm are focusing now on providing information and communication technology support in order to steer away from declining sales revenues from traditional telephony products.

**Vodafone Group Plc** is thought likely to report 1Q service declines in Italy and Spain as the company has found itself with a relatively expensive high quality brand image.

#### Utilities

**India** has been revealed offering to purchase **BP Plc's** stake in a Vietnam natural gas field. **Anadarko** are to meet **BP** executives in order to avoid going to court to settle spill related costs. **Transocean Ltd** employees aboard Deepwater Horizon have become the focus of the US government probe in the disaster. **BP** finally secured the sale of oil and gas Fields in US Canada and Egypt for USD 7Bn to **Apache Corp**. **BP Plc** are also looking to sell Permian Basin holding in Texas and SE NM, along with gas properties in western Canada to **Apache**. **Formosa Plastics Group** has expressed interests in purchasing **BP Plc** assets too. **BP** runs a joint venture with **Formosa Chemicals and Fibre Corp** in Taiwan.

#### Health, Service, Property, Construction & Other

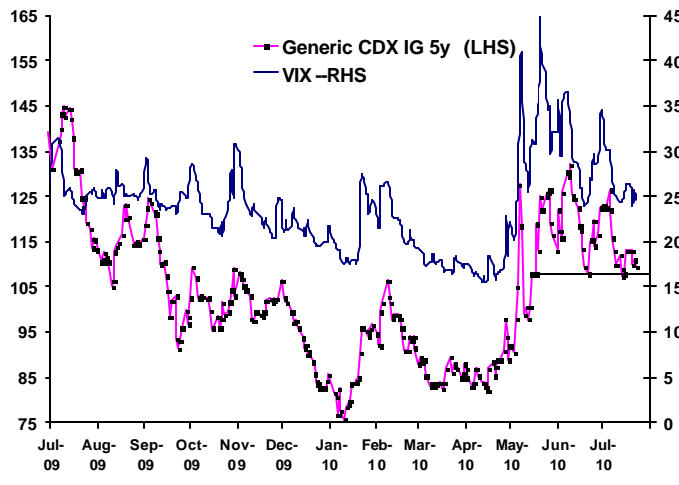
**Roche Holding AG** has announced a 58% increase in 1H profits with net income up at CHF 5.47Bn. Sales at the credit fell during 2Q10 to CHF 9.66Bn. Avastin sales advanced by 7.5% to CHF 1.73Bn, less than what was predicted. . Costs related to the acquisition of **Genetech** were not repeated and cancer medicine sales grew as a result of the acquisition.

## NORTH AMERICA

Corporate credit spreads edged tighter in the aggregate after more than 4 in 5 earnings reporters posted better than expected bottom line numbers Thursday, and with several key reporters offering extremely constructive cash flow, leverage, and fiscal trends (see below). But the range bias holds in advance of whatever constitutes a confirmation of recovery dynamic in the current glum sentiment environment – the latest 109.5bp level for the CDX S14 IG 5y was 1.5bp tighter on the day but still shy of a test of the narrow end of a 107.5-116bp range in place now for 16 sessions. The latest 194.8bp level for the (high- to low-beta) IDEA non-bank broad 5y CDS index remains part of a 193-197bp range over the last 10 sessions, and is little changed net of the last week and month. The latest 147.9bp level for the IDEA Bank index is part of a more volatile 142-155bp range over the last 12 sessions, but a solid 13% tighter net of the last month.

Commercial paper levels edged up a marginal \$2.4bn or 0.2% over the latest week ended July 21, a second straight small increase but still leaving the latest \$1,099.7bn in total CP outstanding just 3.4% above the 12-year low established at the start of June. Financial CP rose 0.3%, Non-Financial CP rose 0.9%, and ABCP declined 0.2%. The only notable development in the latest week was Non-Financial CP topping \$150bn for the first time since mid-June 2009, up from an interim low of \$103bn at the end of 2009.

CDX IG and Vols Still Equivocal Near Test of Mid-May Tights



**Caterpillar: Leveraging Orders Boom, Deleveraging Debt**

Caterpillar (CAT) is back to investing heavily in inventories as machinery orders swell and engine demand starts to play catch-up – the sequential revenue rise in the second quarter was “one of the most significant quarter-to-quarter increases in our history,” CAT said. This has some negative implications for cash flow over the coming quarters, but the company’s ability to leverage demand upticks is impressive since realigning its production chain and greatly reducing costs. The latest 17.5% SG&A margin compares with 20%+ margins through 2009, lifting the operating profit margin to 9.4% for best performance since just ahead of the Lehman collapse. This is still shy of the 10%+ margins from 2005-2007, but a marked improvement from the sub-2% for 2009.

We certainly see scope for 5y CDS (84.5bp last) to see a rapid retracement to the low 60bp levels in April ahead of the spike in sovereign debt concerns and resulting downgrades of global growth prospects. Company commentary certainly suggests that CAT is comfortable with a slow/no growth outlook for Europe given dramatic offsets in LatAm and Asia/Pacific markets and solid profitability in N.A. despite expectations of only a modest increase in expected housing starts over the back half of the year (CAT expects 675K starts for the full year vs a 610K pace over the first half of the year, but with the full year expectation still reflecting the second worst level since 1945 after the 2009 nadir).

Caterpillar Inc raised its top line forecast for the full year (to \$40.5bn at the mid from \$40bn prior, adding distance from the street consensus for \$38.9bn), after posting a stunning 26% sequential rise in revenues (+31% year-to-year). CAT is ramping production to keep up with the swell of demand as orders outpace shipments, primarily from developing markets – while N.A. revs were up a very solid 24% year-to-year, the most dramatic gains remain the +83% for LatAm (including a 116% explosion in machinery sales) and the 45% rise in Asia/Pa-

cific revenues. Europe continues to lag at +8% (including a 15% contraction in engine sales, offset by a 36% rise in machinery sales) and is not expected to break out of its slow/no growth progression over the medium-term.

Overall, machinery drove the growth with engine revenues up just 3%. But we note that the company entered the quarter with lower inventories and months supply of engines year-to-year, and the segment was solidly profitable with \$462m in operating profit for the quarter (-17% year-to-year), not far from the \$477m from the machinery segment despite machinery accounting for nearly two-thirds of consolidated revenue.

Aggressive inventory investment led to a \$2.6bn negative variance in that line item in the cash flow tables year-to-year over the first half of 2010 (operating cash flow down 38% to \$1.7bn), but the company still generated nearly \$900m in free cash over the first six months of the year (vs \$1.9bn over the same period last year) while also reducing equipment level debt by 20% year-to-year and 8% sequentially. Equipment level debt/LTM EBITDA declined to 1.24X through the latest quarter, down from 2.19X at the end of 2009 and 1.76X at the end of June 2009.

Caterpillar Inc (CAT)							
	Moody's A2, Stable S&P A, Stable Fitch A, Stable						
	2Q	1Q	4Q	3Q	2Q	YoY%	QoQ%
	Jun-10	Mar-10	Dec-09	Sep-09	Jun-09	Change	Change
(in millions)							
Total Revenue	10,409	8,238	7,898	7,298	7,975	31	26
Cost of revenues	7,606	6,127	6,090	5,511	6,024	26	24
Gross profit	2,803	2,111	1,808	1,787	1,951	44	33
Gross profit margin	26.9%	25.6%	22.9%	24.5%	24.5%		
SG&A	1,826	1,603	1,680	1,510	1,604	14	14
SG&A as a percentage of revenue	17.5%	19.5%	21.3%	20.7%	20.1%		
EBIT	977	508	128	277	347	182	92
EBIT margin	9.4%	6.2%	1.6%	3.8%	4.4%		
D&A	703	554	703	561	538	31	27
EBITDA	1,680	1,062	831	838	885	90	58
EBITDA margin	16.1%	12.9%	10.5%	11.5%	11.1%		
Interest Expense	81	102	88	91	109	(26)	(21)
Free Cash Flow	712	175	1,007	1,101	1,469	(52)	307
Trailing 12mo Free Cash Flow	2,995	3,752	4,027	2,970	2,313	29	(20)
Total Debt	29,171	30,170	31,631	32,116	33,296	(12)	(3)
Net Debt	25,574	26,632	26,764	27,928	29,305	(13)	(4)
Equipment-Only Debt	5,479	5,967	6,387	6,456	6,851	(20)	(8)
EBITDA/Interest Expense	20.74X	10.41X	9.44X	9.21X	8.12X		
Equipment-Only Debt/LTM EBITDA	1.24X	1.65X	2.19X	2.11X	1.76X		
Total Debt/LTM EBITDA	6.61X	8.34X	10.86X	10.47X	8.53X		

**Xerox Continues to Impress Through ACS Honeymoon**

Xerox (XRX) continues to impress since acquiring services company ACS in February, showcasing its ability to leverage modest economic improvements while pursuing growth in developing markets and from increasing demand from small and mid-sized businesses for higher capacity entry-level products. This is bolstering resources for the planned winnowing of debt from the business over the next 18mos: the company plans a “significant” debt repurchase by the end of the year and ongoing debt reduction in 2011, targeting a 9.5% reduction in debt by the end of 2009 (to \$8.7bn from \$9.6bn at the end of June) and a further 8% reduction over the first nine months of 2011 to \$8bn.

On a pro-forma basis in the second quarter 2010:

\*\*Consolidated revenues rose 2% (+3% constant currency), including technology sales up 3% (+4% constant currency), install activity for Xerox equipment up 45% (including +56% for "entry-level" printers and multifunction devices), and services revenues up 1% (along with 12% growth in signings)

\*\*Operating margin of 10.1% up 90bp year-to-year amid sharply lower SG&A margin.

The company materially increased adjusted EPS guidance to \$0.88 to \$0.92 vs prior \$0.75 to \$0.85 guidance, bringing the low end of the new range above the \$0.87 street consensus. The company continues to expect \$2.6bn in full year operating cash flow, auguring a back half ramp after \$1.05bn generated in the first half.

Free cash flow continues in record territory, offering solid prospects for deleverage (total debt is up 20% year-to-year post-M&A). Free cash flow of \$919m for the first six months of the year lifted the LTM free cash total to \$2.45bn, holding at a record level for a second straight quarter and up 166% from the LTM total through June 2009.

Operating traction is already blunting the impact of higher total and net debt, with total debt/LTM EBITDA down to 4.14X through the latest quarter from 5.34X at the end of 2009 and 4.34X a year ago (if still above the 3.44X at the time of the Lehman collapse).

#### Immediate Benefits from ACS Merger

Xerox (XRX) remains on strong footing since consolidating with ACS on 2/5/10, bolstered by the initial stirrings of corporate spending – as we frequently note, capex reached the lowest levels on record as a percentage of corporate internal funds in 2009, providing plenty of scope for an aggressive ramp as business confidence improves. Xerox is well positioned to leverage that scenario: the ACS business is a very nice fit for Xerox in terms of immediate diversification, with ACS' business process outsourcing (BPO) targeting mainly mid-sized clients vs Xerox's focus on the larger enterprise customers. And better than three quarters of all revenue will be recurring after the merger (83% in both the first and second quarters), offering pleasant annuity-like characteristics to the business. Management chemistry issues will likely be manageable with ACS continuing to operate independently and with the ACS CEO remaining on board to run all of the BPO activities (including those added to ACS from Xerox's more limited BPO presence).

The merger did necessitate a 26% year-to-year increase in total debt and 22% jump in net debt (including a \$2bn in 5-, 10- and 30-year bonds sold 12/1/09, with some proceeds directed to pay down ACS' sr credit facility), but company guidance suggests solid debt service metrics through the synergy-building next few years. Free cash flow (ex-dividends) is tracking for \$2bn in FY2010, not far from the record \$2.1bn in FY2009 and leaving enough cushion to address \$1.8bn in debt payments and \$300m in dividend payments without leaning heavily on cash balances. Better still, the debt maturity schedule eases in FY2011 to

\$800m against \$2.1bn in estimated free cash flow, which should leave some \$1bn in discretionary cash after dividend payments.

That would typically trigger a rote warning on potential fiscal landmines down the road (share buybacks, more aggressive dividend policy), but we take Xerox at its word when it pledged back in September to hold off on share repurchase activity until incurred new debt is paid down. At the time, Moody's appeared to tip that management was dedicated to shelving share repurchases even after a return to pre-acquisition levels to focus free cash on debt reduction and niche acquisitions.

On September 28, 2009 we wrote: "Upside [credit spread] progressions will likely be grinding at best for a few quarters given the slated lurch in financial leverage at a time when a top-line turnaround is anything but assured in 201. Consolidated revenues for Xerox and ACS were down 12% year-to-year in the second quarter of 2009. But this was offset by very effective cost containment with consolidated COGs down 15% (albeit with SG&A down just 6%). And the other major concern with the merger – the heavy concentration of ACS business in the U.S. with nearly two-thirds of consolidated revenue post-merger to occur in the U.S. – is not an intractable issue as the company stands already poised to attack market share internationally. That effort will be greatly enhanced with Xerox as explicit/effective partner. For those with longer target horizons, Xerox appears to be a solid credit for new exposure predicated on the assumption that post-merger credit metrics will improve incrementally at a steady pace into the next decade."

5y CDS was 166bp at the time of that recommendation and indeed spreads drifted wider over the first two months of 4Q09. But spreads tightened significantly after the successful \$2bn bond sale on December 1, to 140bp a week later and 122bp by Jan 7, 2010. But the latest 153bp level reflects the vicissitudes of global growth prognostication in subsequent months through the sovereign debt panic and softening of U.S. economic data into the summer months – we see this as an excellent entry point for higher credit exposure. The new 5y 4.25% 2/15/15 bonds trade almost exactly in line with 5y CDS (bond Z-spread of 151bp), while the less liquid 10-year 5.625% bonds traded about 10bp wide of 10y CDS (181bp) just after results.

Xerox Corp (XRX) -- GAAP							
	Moody's Baa2, Stable						
	S&P BBB-, Stable						
	Fitch BBB, Negative						
	2Q	1Q	4Q	3Q	2Q	YoY%	QoQ%
	Jun-10	Mar-10	Dec-09	Sep-09	Jun-09	Change	Change
(in millions)							
Total Revenue	5,508	4,721	4,219	3,675	3,731	48	17
Cost of revenues	3,592	3,017	2,537	2,211	2,233	61	19
Gross profit	1,916	1,704	1,682	1,464	1,498	28	12
Gross profit margin	34.8%	36.1%	39.9%	39.8%	40.2%		
SG&A	1,357	1,361	1,350	1,216	1,215	12	(0)
SG&A as a percentage of revenue	24.6%	28.8%	32.0%	33.1%	32.6%		
EBIT	559	343	332	248	283	98	63
EBIT margin	10.1%	7.3%	7.9%	6.7%	7.6%		
D&A	241	241	185	176	168	43	-
EBITDA	800	584	517	424	451	77	37
EBITDA margin	14.5%	12.4%	12.3%	11.5%	12.1%		
Free Cash Flow	595	324	941	589	598	(1)	84
Trailing LTM Free Cash Flow	2,449	2,452	2,113	1,293	921	166	(0)
Total Debt	9,617	9,964	9,264	7,446	8,037	20	(3)
Net Debt	8,535	8,954	5,465	6,287	6,816	25	(5)
Total Debt/LTM EBITDA	4.14X	5.04X	5.34X	4.30X	4.39X		

Bottom line, XRX is back to offering at least a modest value proposition at current levels, with the balance of risks clearly favors incremental tightening into 2011 as the company steadily delevers. We target 125bp for 5y exposures over the next 3mos and a test of the 100bp level by the end of 1Q11.

### 3M Flirts With Peak Operational Metrics

3M (MMM) posted strong 2Q results, including operating margin of 23.7% that is not only up 290bp vs a weak year ago comp but rivals the best performance in the company's history. Leverage (total debt/LTM EBITDA) at 0.81X at the end of June is back to the lowest levels since the early days of the crisis in 4Q07, down from 1.12X a year earlier – this comes with total debt down 7% year-to-year but with net debt down 76% to a highly constructive \$746m. That level of net debt pales in comparison with more than \$4bn in LTM free cash generation in each of the last three quarters, by far the strongest in the company's history. There appears to be no immediate risk to that progression: The company expects \$1bn in capex for the full year, up from \$903m in a cautious 2009 but still below the \$1.35bn average over the previous three years.

MMM's potent liquidity position obviously raises the risk of an M&A binge over the coming quarters and also a return to aggressive direct shareholder fiscal returns. But the company's near-peak operational metrics and extremely low leverage provide ample lead time for credit red flags to be identified – we are neutral on the name in the credit markets given rich valuations (4.375% 8/15/13 bullet structure valued below 10bp on a Z-spread basis, less than half the 3y CDS level) but would certainly see limited scope for profit in a short credit/long CDS position.

### Royal Caribbean CDS Near Wides Despite Leading Edge of Strong FCF

Royal Caribbean (RCL), which saw its 5y CDS explode to 550bp in July from 315bp in April ahead of the sovereign debt panic, is certainly singing out for increased long credit exposure as it prepares to transition into a period of strong free cash generation and attendant deleverage potential. With the company indicating that it is comfortable with its current lineup after a huge spending program over the last five years (culminating in the massive new Allure of the Seas and Oasis of the Seas flagships), Royal Caribbean now has the opportunity to optimize costs such that it could actually generate free cash for the first time in five years in 2010 with significant free cash prospects in 2011 and 2012 as capex plunges from an expected \$2.2bn in 2010 to \$1bn each in 2011 and 2012 (with attendant declines in capacity growth from 11.5% in 2010 to 7.1% in 2011 and 2% in 2012).

As articulated in the first quarter report, the company has no plans to tap the capital markets for the foreseeable future "outside of possible opportunistic actions." That should make the record \$8.4bn in total RCL debt and nearly 8X total debt/LTM EBITDA metric at the end of 2009 the peak levels for at least the next several years, with total debt and net debt already down 4% over the first half of 2010 and operating debt leverage down to 6.57X (if still up year-to-year from 5.78X).

The cash flow prospects are certainly enticing with operating profits poised to expand and capex decline – the company has not generated annual free cash flow since the \$681m in FY 2005 when capex was just \$430m. Capex would then ramp sharply from there over four straight years, culminating in the record \$2.5bn in FY 2009 capex and a record usage of free cash of -\$1.6bn.

Company capex guidance was affirmed Thursday, pointing to an ebb to \$2.2bn in FY 2010 and a steep decline to \$1bn in both FY 2011 and FY 2012. Even with a big expected jump in EBITDA, it would be a feat – but not impossible amid rising bookings -- for the company to throw off FCF in 2010 given that the prior peak for operating cash flow was \$1.3bn in 2007. Free cash flow was positive net of the first 6mos of 2010 at +\$164m, but with capex YTD accounting for just 38.5% of the expected full-year total (the Allure flagship is scheduled for delivery later this year).

But we certainly see scope for material free cash flow in 2011 and 2012, lowering the liquidity pressures ahead of a sharp ramp in debt maturities (from a total of \$750m over FY 2010 and FY 2011, to \$900m in FY 2013 and a peak of \$1.3bn in FY 2014).

Bottom line, RCL continues to sound pleasantly fiscally conservative for the time being, which may just be enough to allow a once dubious proposition in the credit markets to safely skirt the looming "refinancing cliff." Underlying yields and market conditions in the years to come will have a lot to do with how economical those refinancing conditions will prove to be (not to mention the trajectory of discretionary consumer spending power), but there is at least now a clear path to deleverage with capex in the rear view.  
(see table, next page)

3M Corp (MMM)							
	Moody's Aa2; Stable						
	S&P AA-, Stable						
	2Q	1Q	4Q	3Q	2Q	YoY%	QoQ%
	Jun-10	Mar-10	Dec-09	Sep-09	Jun-09	Change	Change
(in millions)							
Total Revenue	6,731	6,348	6,122	6,193	5,719	18	6
Cost of revenues	3,435	3,238	3,189	3,171	2,977	15	6
Gross profit	3,296	3,110	2,933	3,022	2,742	20	6
Gross profit margin	49.0%	49.0%	47.9%	48.8%	47.9%		
SG&A	1,700	1,665	1,591	1,544	1,551	10	2
SG&A as a percentage of revenue	25.3%	26.2%	26.0%	24.9%	27.1%		
EBIT	1,596	1,445	1,342	1,478	1,191	34	10
EBIT margin	23.7%	22.8%	21.9%	23.9%	20.8%		
D&A	287	287	298	290	298	(4)	-
EBITDA	1,883	1,732	1,640	1,768	1,489	26	9
EBITDA margin	28.0%	27.3%	26.8%	28.5%	26.0%		
Interest Expense	52	48	54	55	55	(5)	8
Free Cash Flow	958	925	770	1,561	1,256	(24)	4
Trailing 12mo Free Cash Flow	4,214	4,512	4,038	3,930	3,161	33	(7)
Total Debt	5,677	5,778	5,710	6,125	6,080	(7)	(2)
Net Debt	746	1,171	1,926	2,189	3,106	(76)	(36)
EBITDA/Interest Expense	36.21X	36.08X	30.37X	32.15X	27.07X		
Total Debt/LTM EBITDA	0.81X	0.87X	0.96X	1.14X	1.12X		

Royal Caribbean Cruises Ltd (RCL)							
	Moody's Ba2, Stable						
	S&P BB-, Stable						
	2Q	1Q	4Q	3Q	2Q	YoY%	QoQ%
	Jun-10	Mar-10	Dec-09	Sep-09	Jun-09	Change	Change
(in millions)							
Total Revenue	1,602	1,486	1,452	1,764	1,349	19	8
Cost of revenues	653	608	619	691	563	16	7
Gross profit	949	878	833	1,073	786	21	8
Gross profit margin	59.2%	59.1%	57.4%	60.8%	58.3%		
SG&A	805	787	750	765	731	10	2
SG&A as a percentage of revenue	50.2%	53.0%	51.7%	43.4%	54.2%		
EBIT	144	91	83	308	55	162	58
EBIT margin	9.0%	6.1%	5.7%	17.5%	4.1%		
D&A	160	158	146	144	138	16	1
EBITDA	304	249	229	452	193	58	22
EBITDA margin	19.0%	16.8%	15.8%	25.6%	14.3%		
Interest Expense	84	84	78	74	68	24	-
Free Cash Flow	(83)	247	(1,143)	(509)	125		
Trailing 12mo Free Cash Flow	(1,489)	(1,281)	(1,633)	(1,273)	(581)		
Total Debt	8,110	8,104	8,420	7,296	6,769	20	0
Net Debt	7,792	7,826	8,135	7,010	6,459	21	(0)
EBITDA/Interest Expense	3.62X	2.96X	2.94X	6.11X	2.84X		
Total Debt/LTM EBITDA	6.57X	7.22X	7.95X	7.10X	5.78X		

	7/22/10	7/21/10	Day Bp Change	Day % Change	WoW Bp Change	WoW % Change	MoM Bp Change	MoM % Change	YoY Bp Change	YoY % Change	3mo Avg	% Diff vs 3mo avg
US Sector Basket (5y CDS)	194.8	195.9	(1.1)	-0.6%	0.5	0.3%	1.2	0.6%	(68.7)	-26.1%	189.3	2.9%
125-Name Sample Average	194.8	195.9	(1.1)	-0.6%	0.5	0.3%	1.2	0.6%	(68.7)	-26.1%	189.3	2.9%
Aero/Defense	105.0	108.1	(3.1)	-2.9%	(3.4)	-3.1%	(3.0)	-2.8%	(137.0)	-56.6%	105.7	-0.7%
Agri/Food	405.0	406.1	(1.1)	-0.3%	(5.8)	-1.4%	(4.8)	-1.2%	28.6	7.6%	394.7	2.6%
Autos/Parts	538.8	543.9	(5.1)	-0.9%	(4.1)	-0.8%	(24.8)	-4.4%	(576.9)	-51.7%	562.7	-4.3%
Chemicals	99.0	99.0	0.0	0.0%	2.5	2.6%	2.2	2.2%	(18.5)	-15.7%	101.8	-2.7%
Consumer Products	72.3	72.7	(0.4)	-0.6%	(0.4)	-0.6%	(4.6)	-6.0%	23.5	48.0%	74.7	-3.2%
Homebuilding	383.4	385.1	(1.7)	-0.4%	(0.9)	-0.2%	30.8	8.7%	(173.9)	-31.2%	343.7	11.6%
Industrial	140.9	141.4	(0.6)	-0.4%	1.6	1.1%	9.1	6.9%	(108.9)	-43.6%	131.1	7.4%
Insurance	184.3	184.3	0.0	0.0%	2.4	1.3%	2.8	1.5%	(52.1)	-22.0%	174.7	5.5%
Leisure	282.0	286.3	(4.3)	-1.5%	(5.3)	-1.9%	21.0	8.0%	(145.7)	-34.1%	256.0	10.2%
Media	285.8	291.0	(5.2)	-1.8%	(1.3)	-0.5%	6.3	2.3%	(346.5)	-54.8%	285.0	0.3%
Metals/Mining	216.9	216.8	0.1	0.0%	5.6	2.7%	6.5	3.1%	(21.9)	-9.2%	205.4	5.6%
OG&E	137.3	139.5	(2.2)	-1.6%	0.8	0.6%	(19.0)	-12.2%	8.9	6.9%	135.9	1.0%
Paper	168.1	169.3	(1.2)	-0.7%	4.5	2.8%	(5.6)	-3.2%	(91.7)	-35.3%	174.2	-3.5%
Pharmaceutical/Medical	58.4	58.9	(0.5)	-0.8%	(1.1)	-1.8%	(5.7)	-8.9%	13.5	30.1%	62.4	-6.5%
REIT	162.7	163.0	(0.3)	-0.2%	0.3	0.2%	(11.5)	-6.6%	(128.8)	-44.2%	162.6	0.0%
Retail	177.3	177.3	0.1	0.0%	1.3	0.8%	19.6	12.4%	(40.8)	-18.7%	160.1	10.8%
TMT/CME	194.3	195.0	(0.7)	-0.4%	1.6	0.8%	0.5	0.2%	(60.4)	-23.7%	196.6	-1.2%
Utility	93.0	93.2	(0.2)	-0.2%	(3.7)	-3.8%	(15.8)	-14.5%	14.8	19.0%	94.9	-2.0%

	7/22/10	7/21/10	Day Bp Change	Day % Change	WoW Bp Change	WoW % Change	MoM Bp Change	MoM % Change	YoY Bp Change	YoY % Change	3mo Avg	% Diff vs 3mo avg
US Bank Entity (5y CDS)	100.0	100.0	0.0	0.0%	4.0	4.2%	(17.0)	-14.5%	(65.7)	-39.7%	115.4	-13.3%
American Express (AXP)	100.0	100.0	0.0	0.0%	4.0	4.2%	(17.0)	-14.5%	(65.7)	-39.7%	115.4	-13.3%
Bank of America (BAC)	148.0	148.0	0.0	0.0%	7.5	5.3%	(15.5)	-9.5%	(5.0)	-3.2%	153.9	-3.8%
Citigroup ( C )	174.0	175.0	(1.0)	-0.6%	1.0	0.6%	(23.0)	-11.7%	(196.2)	-53.0%	186.5	-6.7%
Goldman Sachs (GS)	162.5	163.0	(0.5)	-0.3%	(12.5)	-7.1%	(30.5)	-15.8%	31.9	24.4%	181.2	-10.3%
JPMorgan Chase (JPM)	99.0	100.0	(1.0)	-1.0%	3.0	3.1%	(18.5)	-15.7%	21.0	26.9%	107.1	-7.6%
Merrill Lynch	177.5	177.5	0.0	0.0%	4.5	2.6%	(16.0)	-8.3%	1.4	0.8%	191.4	-7.3%
Morgan Stanley	220.0	220.0	0.0	0.0%	(12.0)	-5.2%	(40.0)	-15.4%	17.0	8.4%	230.7	-4.6%
Wells Fargo	102.0	104.0	(2.0)	-1.9%	0.0	0.0%	(16.5)	-13.9%	(9.2)	-8.3%	107.8	-5.4%
IDEA Bank Index (5y CDS)	147.9	148.4	(0.6)	-0.4%	(0.6)	-0.4%	(22.1)	-13.0%	(25.6)	-14.8%	159.2	-7.1%

US Reference Entity (5y CDS)	7/22/10	7/21/10	Day Bp Change	Day % Change	WoW Bp Change	WoW % Change	MoM Bp Change	MoM % Change	YoY Bp Change	YoY % Change	3mo Avg	% Diff vs 3mo avg
3M (MMM)	34.5	35	(0.5)	-1.4%	(1.0)	-2.8%	(2.0)	-5.5%	(13.5)	-28.1%	37.2	-7.2%
Aetna Inc (AET)	79.5	78.5	1.0	1.3%	(0.5)	-0.6%	(7.0)	-8.1%	14.5	22.3%	90.2	-11.8%
Alcatel-Lucent (ALU)	775	778	(3.0)	-0.4%	20.0	2.6%	65.0	9.2%	27.0	3.6%	712.0	8.9%
Alcoa Inc (AA)	358	358.5	(0.5)	-0.1%	7.0	2.0%	(5.0)	-1.4%	(43.7)	-10.9%	333.4	7.4%
Allstate (ALL)	119	118	1.0	0.8%	19.0	19.0%	30.0	33.7%	11.0	10.2%	95.0	25.3%
Altria (MO)	134	134.5	(0.5)	-0.4%	0.5	0.4%	(61.0)	-31.3%	56.5	72.9%	169.6	-21.0%
Anheuser-Busch InBev (ABI.BR)	57	57	0.0	0.0%	(1.0)	-1.7%	(2.0)	-3.4%	(16.0)	-21.9%	52.6	8.4%
Archer Daniels Midland (ADM)	60.5	60.5	0.0	0.0%	0.5	0.8%	1.0	1.7%	(9.5)	-13.6%	59.1	2.3%
ArvinMeritor (ARM)	703	706.5	(3.5)	-0.5%	(3.0)	-0.4%	(22.0)	-3.0%	(755.0)	-51.8%	714.3	-1.6%
AT&T Inc (T)	90	89	1.0	1.1%	1.0	1.1%	(2.0)	-2.2%	0.0	0.0%	93.6	-3.8%
AutoZone (AZO)	67	66	1.0	1.5%	1.0	1.5%	(1.5)	-2.2%	19.5	41.1%	81.4	-17.7%
Baker Hughes (BHI)	82.5	90	(7.5)	-8.3%	(12.5)	-13.2%	(25.5)	-23.6%	31.0	60.2%	89.0	-7.3%
Barrick Gold (ABX)	74	73	1.0	1.4%	4.0	5.7%	(1.0)	-1.3%	(22.0)	-22.9%	80.9	-8.5%
Beazer Homes (BZH)	796.5	799	(2.5)	-0.3%	(27.5)	-3.3%	86.5	12.2%	(977.5)	-55.1%	700.5	13.7%
BHP Billiton (BHP)	85	81	4.0	4.9%	(0.5)	-0.6%	(2.0)	-2.3%	5.0	6.3%	83.9	1.4%
Black & Decker (BDK)	30.5	31	(0.5)	-1.6%	(0.5)	-1.6%	(0.5)	-1.6%	(117.0)	-79.3%	32.8	-7.1%
Boeing Co (BA)	66.5	66.5	0.0	0.0%	(2.0)	-2.9%	(1.5)	-2.2%	(46.5)	-41.2%	71.2	-6.6%
Boston Properties (BXP)	147	147	0.0	0.0%	0.0	0.0%	(12.5)	-7.8%	(118.0)	-44.5%	149.0	-1.3%
Boston Scientific (BSX)	161.5	161.5	0.0	0.0%	(0.5)	-0.3%	(37.5)	-18.8%	71.5	79.4%	174.5	-7.5%
Bristol-Myers Squibb (BMY)	37	37.5	(0.5)	-1.3%	(0.5)	-1.3%	(8.0)	-17.8%	14.0	60.9%	47.8	-22.6%
Brunswick (BC)	561	562	(1.0)	-0.2%	12.0	2.2%	71.0	14.5%	(504.0)	-47.3%	476.0	17.9%
Centex Corp (CTX)	168	170	(2.0)	-1.2%	0.5	0.3%	9.0	5.7%	19.5	13.1%	149.2	12.6%
Chevron (CVX)	62	63	(1.0)	-1.6%	(2.0)	-3.1%	3.5	6.0%	3.0	5.1%	51.6	20.2%
Chubb (CB)	89.5	90	(0.5)	-0.6%	2.5	2.9%	14.5	19.3%	39.0	77.2%	77.2	16.0%
Clorox (CLX)	73.5	72.5	1.0	1.4%	(0.5)	-0.7%	(1.5)	-2.0%	37.5	104.2%	74.1	-0.8%
Coca-Cola Co (KO)	42	42	0.0	0.0%	0.0	0.0%	0.0	0.0%	1.5	3.7%	43.2	-2.8%
Colgate-Palmolive (CL)	50	51	(1.0)	-2.0%	(0.5)	-1.0%	(0.5)	-1.0%	14.0	38.9%	49.7	0.5%
Comcast Corp (CMCSA)	114	113.5	0.5	0.4%	0.5	0.4%	(3.0)	-2.6%	(2.5)	-2.1%	119.6	-4.7%
Computer Sciences Corp (CSC)	101	103.5	(2.5)	-2.4%	(3.0)	-2.9%	(6.0)	-5.6%	58.0	134.9%	114.5	-11.8%
ConocoPhillips (COP)	61	62.5	(1.5)	-2.4%	(3.0)	-4.7%	(6.0)	-9.0%	12.5	25.8%	63.3	-3.7%
Cooper Tire & Rubber (CTB)	378.5	381	(2.5)	-0.7%	4.5	1.2%	(6.5)	-1.7%	(207.0)	-35.4%	413.4	-8.4%
D.R. Horton (DHI)	283.5	285	(1.5)	-0.5%	6.5	2.3%	26.5	10.3%	18.5	7.0%	248.1	14.3%
Dean Foods (DF)	724	724	0.0	0.0%	(10.0)	-1.4%	8.0	1.1%	358.0	97.8%	682.0	6.2%
Deere & Co (DE)	62	63	(1.0)	-1.6%	(1.0)	-1.6%	(4.0)	-6.1%	(28.5)	-31.5%	69.7	-11.0%
Dell Inc (DELL)	112	111.5	0.5	0.4%	1.0	0.9%	8.0	7.7%	38.0	51.4%	102.3	9.5%
Devon Energy (DVN)	74	74	0.0	0.0%	(4.0)	-5.1%	(14.0)	-15.9%	17.0	29.8%	82.9	-10.8%
Dominion Resources (D)	49.5	50	(0.5)	-1.0%	(1.0)	-2.0%	(10.0)	-16.8%	4.0	8.8%	61.2	-19.2%
Domtar Corp (UFS)	216	213	3.0	1.4%	12.0	5.9%	(44.0)	-16.9%	(392.0)	-64.5%	239.7	-9.9%
Dow Chemical (DOW)	162.5	162.5	0.0	0.0%	6.0	3.8%	4.0	2.5%	(62.5)	-27.8%	154.3	5.3%
Duke Energy (DUK)	58	58.5	(0.5)	-0.9%	(0.5)	-0.9%	(8.5)	-12.8%	15.5	36.5%	69.4	-16.4%
Duke Realty (DRE)	202	203	(1.0)	-0.5%	0.0	0.0%	(7.0)	-3.3%	(208.5)	-50.8%	194.1	4.1%
DuPont (DD)	57.5	57.5	0.0	0.0%	0.5	0.9%	(6.5)	-10.2%	0.0	0.0%	71.5	-19.5%
Eastman Chemical (EMN)	77	77	0.0	0.0%	1.0	1.3%	9.0	13.2%	7.0	10.0%	79.6	-3.2%
Eastman Kodak (EK)	944	948	(4.0)	-0.4%	14.5	1.6%	2.0	0.2%	(725.0)	-43.4%	920.1	2.6%
El Paso Corp (EP)	314.5	335	(20.5)	-6.1%	(19.5)	-5.8%	(50.5)	-13.8%	(328.5)	-51.1%	356.5	-11.8%
Eli Lilly (LLY)	47	47	0.0	0.0%	0.5	1.1%	(4.0)	-7.8%	16.5	54.1%	55.1	-14.6%
ExxonMobil (XOM)	52	54.5	(2.5)	-4.6%	1.0	2.0%	19.0	57.6%	13.0	33.3%	33.1	56.9%
Ford Motor Co (F)	641	646	(5.0)	-0.8%	(6.0)	-0.9%	(17.0)	-2.6%	(955.0)	-59.8%	644.6	-0.6%
Ford Motor Credit Co (F)	432.5	442	(9.5)	-2.1%	(12.0)	-2.7%	(53.5)	-11.0%	(390.5)	-47.4%	478.6	-9.6%
Gannett (GCI)	345	350	(5.0)	-1.4%	(1.5)	-0.4%	16.0	4.9%	(546.0)	-61.3%	348.4	-1.0%
Gap Inc (GPS)	61	61	0.0	0.0%	0.5	0.8%	3.5	6.1%	25.5	71.8%	63.6	-4.0%
GlaxoSmithKline (GSK)	65	66	(1.0)	-1.5%	1.0	1.6%	20.0	44.4%	16.0	32.7%	49.6	31.1%
H.J. Heinz (HNZ)	67.5	68	(0.5)	-0.7%	(0.5)	-0.7%	1.0	1.5%	34.0	101.5%	69.1	-2.3%
Hartford Financial (HIG)	297.5	297	0.5	0.2%	(1.5)	-0.5%	(6.0)	-2.0%	(261.5)	-46.8%	285.0	4.4%
Hess Corp (HES)	110	110	0.0	0.0%	0.5	0.5%	(7.0)	-6.0%	(18.5)	-14.4%	108.6	1.3%
Hewlett-Packard (HPQ)	40	40	0.0	0.0%	0.0	0.0%	(2.0)	-4.8%	1.0	2.6%	42.8	-6.4%
Home Depot (HD)	76.5	76	0.5	0.7%	0.0	0.0%	14.5	23.4%	(1.0)	-1.3%	68.2	12.2%
Honeywell (HON)	44.5	44.5	0.0	0.0%	(3.0)	-6.3%	(6.0)	-11.9%	(6.5)	-12.7%	52.1	-14.5%
Humana (HUM)	160	160.5	(0.5)	-0.3%	(1.0)	-0.6%	(9.0)	-5.3%	(136.0)	-45.9%	173.1	-7.6%
Ingersoll-Rand (IR)	39	39	0.0	0.0%	0.5	1.3%	(1.5)	-3.7%	(34.5)	-46.9%	45.7	-14.6%
International Paper (IP)	151	152.5	(1.5)	-1.0%	3.0	2.0%	(11.5)	-7.1%	(68.5)	-31.2%	159.9	-5.6%
Interpublic Group (IPG)	285.5	292	(6.5)	-2.2%	(12.5)	-4.2%	(7.0)	-2.4%	(257.5)	-47.4%	277.1	3.0%

US Reference Entity (5y CDS)	7/22/10	7/21/10	Day Bp	Day %	WoW Bp	WoW %	MoM Bp	MoM %	YoY Bp	YoY %	3mo Avg	% Diff vs 3mo avg
			Change	Change	Change	Change	Change	Change	Change	Change		
JCPenney (JCP)	213	212	1.0	0.5%	6.0	2.9%	45.0	26.8%	14.0	7.0%	171.3	24.4%
Jones Apparel (JNY)	202	200	2.0	1.0%	11.0	5.8%	32.0	18.8%	(173.5)	-46.2%	171.1	18.1%
Kellogg Co (K)	55.5	56.5	(1.0)	-1.8%	(1.0)	-1.8%	0.5	0.9%	17.5	46.1%	56.3	-1.3%
Kohl's (KSS)	95	96	(1.0)	-1.0%	(2.0)	-2.1%	4.5	5.0%	8.0	9.2%	90.4	5.0%
Kraft Foods (KFT)	64	64	0.0	0.0%	0.5	0.8%	(1.5)	-2.3%	24.0	60.0%	66.0	-3.0%
Level 3 Communications (LVL3)	1354	1360	(6.0)	-0.4%	6.5	0.5%	31.0	2.3%	118.0	9.5%	1252.3	8.1%
Limited Brands (LTD)	232	230	2.0	0.9%	5.0	2.2%	40.0	20.8%	(71.0)	-23.4%	198.4	16.9%
Loews (L)	125	125	0.0	0.0%	1.0	0.8%	2.0	1.6%	74.0	145.1%	107.6	16.2%
Macy's (M)	213	212	1.0	0.5%	3.0	1.4%	26.0	13.9%	(151.5)	-41.6%	186.2	14.4%
Marriott International (MAR)	128	130.5	(2.5)	-1.9%	(4.0)	-3.0%	(7.0)	-5.2%	(61.5)	-32.5%	132.3	-3.3%
Mattel (MAT)	158	160	(2.0)	-1.3%	(2.0)	-1.3%	15.0	10.5%	108.0	216.0%	146.6	7.8%
MeadWestvaco (MWV)	150.5	153	(2.5)	-1.6%	0.5	0.3%	20.5	15.8%	62.0	70.1%	136.9	9.9%
Merck (MRK)	31	31	0.0	0.0%	0.0	0.0%	(3.5)	-10.1%	(3.0)	-8.8%	34.9	-11.2%
MetLife (MET)	302.5	303	(0.5)	-0.2%	(1.5)	-0.5%	(15.5)	-4.9%	(138.5)	-31.4%	296.2	2.1%
Motorola (MOT)	76	76	0.0	0.0%	0.5	0.7%	(9.0)	-10.6%	(150.0)	-66.4%	107.6	-29.4%
New York Times (NYT)	227	231	(4.0)	-1.7%	10.0	4.6%	10.0	4.6%	(236.0)	-51.0%	229.7	-1.2%
Newmont Mining (NEM)	80	79	1.0	1.3%	1.0	1.3%	(1.0)	-1.2%	(32.0)	-28.6%	86.6	-7.7%
Nordstrom (JWN)	121	121	0.0	0.0%	2.5	2.1%	8.5	7.6%	(78.0)	-39.2%	113.0	7.1%
Norfolk Southern (NSC)	43.5	44	(0.5)	-1.1%	1.5	3.6%	(3.5)	-7.4%	(0.5)	-1.1%	51.2	-15.1%
Northrop Grumman (NOC)	64	64	0.0	0.0%	1.0	1.6%	(3.0)	-4.5%	23.0	56.1%	69.1	-7.4%
Occidental Petroleum (OXY)	59	59	0.0	0.0%	(1.0)	-1.7%	(7.0)	-10.6%	9.0	18.0%	59.5	-0.9%
Pacific Gas & Electric (PCG)	139	139	0.0	0.0%	(5.0)	-3.5%	(33.0)	-19.2%	7.0	5.3%	136.8	1.6%
PepsiCo (PEP)	44.5	45	(0.5)	-1.1%	(0.5)	-1.1%	0.5	1.1%	0.0	0.0%	43.5	2.2%
Procter & Gamble (PG)	49	49	0.0	0.0%	0.5	1.0%	(1.5)	-3.0%	(19.0)	-27.9%	50.9	-3.7%
Prudential Financial (PRU)	255	257	(2.0)	-0.8%	(0.5)	-0.2%	3.0	1.2%	(186.5)	-42.2%	242.0	5.4%
Pulte Homes (PHM)	300.5	301.5	(1.0)	-0.3%	13.5	4.7%	44.5	17.4%	76.5	34.2%	250.2	20.1%
Qwest Corp (Q)	114	114	0.0	0.0%	0.0	0.0%	0.0	0.0%	(230.0)	-66.9%	114.0	0.0%
RadioShack Corp (RSH)	347	351.5	(4.5)	-1.3%	(21.0)	-5.7%	50.0	16.8%	197.0	131.3%	273.2	27.0%
Raytheon (RTN)	60	60	0.0	0.0%	1.0	1.7%	(4.0)	-6.3%	19.0	46.3%	66.2	-9.4%
Royal Caribbean (RCL)	528	536.5	(8.5)	-1.6%	(9.0)	-1.7%	61.0	13.1%	(193.5)	-26.8%	451.1	17.0%
Safeway Inc (SWY)	89	88.5	0.5	0.6%	0.0	0.0%	3.0	3.5%	16.5	22.8%	90.0	-1.2%
Saks Inc (SKS)	658	661	(3.0)	-0.5%	9.0	1.4%	41.0	6.6%	(380.0)	-36.6%	630.8	4.3%
Schering-Plough (SGP)	48	50	(2.0)	-4.0%	(8.0)	-14.3%	(6.0)	-11.1%	(10.0)	-17.2%	55.4	-13.4%
Simon Property (SPG)	139	139	0.0	0.0%	1.0	0.7%	(15.0)	-9.7%	(60.0)	-30.2%	144.8	-4.0%
Smithfield Foods Inc (SFD)	647.5	651	(3.5)	-0.5%	(16.5)	-2.5%	(27.5)	-4.1%	(223.0)	-25.6%	649.4	-0.3%
Southern Co (SO)	82	82	0.0	0.0%	(5.5)	-6.3%	(6.0)	-6.8%	22.0	36.7%	78.6	4.3%
Sprint Nextel (S)	389	392	(3.0)	-0.8%	(5.0)	-1.3%	(22.0)	-5.4%	37.0	10.5%	427.3	-9.0%
Standard Pacific (SPF)	560	562	(2.0)	-0.4%	(1.5)	-0.3%	14.0	2.6%	(241.5)	-30.1%	524.6	6.7%
Starwood Hotels (HOT)	190	192	(2.0)	-1.0%	(3.0)	-1.6%	9.0	5.0%	(182.0)	-48.9%	184.5	3.0%
Sun Microsystems (JAVA)	26.5	27	(0.5)	-1.9%	(1.0)	-3.6%	(0.5)	-1.9%	(20.5)	-43.6%	27.1	-2.4%
Target Corp (TGT)	60	58.5	1.5	2.6%	2.0	3.4%	5.0	9.1%	(1.0)	-1.6%	55.6	7.8%
Temple-Inland (TIN)	148	151	(3.0)	-2.0%	6.0	4.2%	(1.0)	-0.7%	(70.5)	-32.3%	158.8	-6.8%
Tenet Healthcare (THC)	585.5	584	1.5	0.3%	7.0	1.2%	4.0	0.7%	(172.5)	-22.8%	590.5	-0.8%
Textron Financial (TXT)	229.5	242	(12.5)	-5.2%	(13.5)	-5.6%	(3.5)	-1.5%	(543.5)	-70.3%	216.4	6.1%
Time Warner (TWX)	55.5	56	(0.5)	-0.9%	0.0	0.0%	(8.0)	-12.6%	(7.5)	-11.9%	67.2	-17.4%
Toll Brothers (TOL)	192	193	(1.0)	-0.5%	3.0	1.6%	4.0	2.1%	61.0	46.6%	189.2	1.5%
Transocean Inc (RIG)	470	461	9.0	2.0%	57.0	13.8%	(61.0)	-11.5%	387.0	466.3%	381.6	23.2%
Travelers Cos (TRV)	106	106	0.0	0.0%	7.5	7.6%	18.5	21.1%	19.0	21.8%	88.0	20.5%
Tyson Foods Inc (TSN)	188	189	(1.0)	-0.5%	3.0	1.6%	(0.5)	-0.3%	(11.0)	-5.5%	188.2	-0.1%
United States Steel	487.5	492.5	(5.0)	-1.0%	16.5	3.5%	41.5	9.3%	(17.0)	-3.4%	442.3	10.2%
Unum Group (UNM)	309	308	1.0	0.3%	(1.0)	-0.3%	(2.5)	-0.8%	44.0	16.6%	293.1	5.4%
Valero Energy (VLO)	194	195	(1.0)	-0.5%	2.0	1.0%	(42.0)	-17.8%	(24.0)	-11.0%	218.9	-11.4%
Verizon Comms (VZ)	89.5	89.5	0.0	0.0%	(1.0)	-1.1%	(8.5)	-8.7%	32.0	55.7%	102.2	-12.5%
Viacom (VIA)	86.5	86	0.5	0.6%	0.5	0.6%	0.5	0.6%	(18.5)	-17.6%	88.0	-1.7%
Wal-Mart Stores (WMT)	48	48	0.0	0.0%	1.5	3.2%	3.0	6.7%	4.0	9.1%	47.8	0.4%
Walt Disney (DIS)	51	51	0.0	0.0%	1.0	2.0%	(1.0)	-1.9%	1.0	2.0%	54.9	-7.1%
Waste Management (WMI)	134.5	135	(0.5)	-0.4%	(0.5)	-0.4%	(1.5)	-1.1%	55.5	70.3%	132.5	1.5%
Wells Fargo (WFC)	102	104	(2.0)	-1.9%	0.0	0.0%	(16.5)	-13.9%	(10.0)	-8.9%	107.7	-5.3%
Weyerhaeuser (WY)	175	177	(2.0)	-1.1%	1.0	0.6%	8.0	4.8%	10.5	6.4%	175.9	-0.5%
Whirlpool (WHR)	124.5	125	(0.5)	-0.4%	1.5	1.2%	2.5	2.0%	(120.5)	-49.2%	124.0	0.4%
Williams Cos (WMB)	119	120	(1.0)	-0.8%	(8.0)	-6.3%	(28.0)	-19.0%	1.5	1.3%	124.9	-4.7%
Wyeth (WYE)	19	19	0.0	0.0%	0.0	0.0%	(1.0)	-5.0%	(10.5)	-35.6%	19.5	-2.7%

## ECONOMY/MARKETS

**At least 5 of the 6 Greek banks being stress-tested will pass, according to the WSJ.**

**Bernanke** said on Thurs that in **short term**, should maintain a reasonable degree of fiscal stimulus; **longer term** need to take steps on controlling deficits. Labor market situation 'unsatisfactory.' Repeats options for Fed going forward would include reducing interest on reserves, buying more securities if conditions warrant. Said our baseline scenario is as effects of financial crisis pass, moderate growth in economy will be seen. Adds European situation is improving, confidence coming back. Although some US data has been disappointing, Fed has no basis to radically change its outlook.

**Fed Chairman Bernanke** says unemployment is the most important problem right now. Most modeling exercises suggest fiscal policies created 1-3 million jobs. Hears often from businesses about uncertainty delaying investment but can't quantify it. Fed could reintroduce some special lending programs in unlikely case of spillover from Europe debt crisis. 'Unusually uncertain' comment was based on latest Fed survey of its members, majority of whom said conditions were more uncertain than normal

**The US House** voted in favor of restoring emergency unemployment benefits for 2.5mln unemployed, sending the measure to President Obama.

**US June Conference Board leading economic indicators** report revealed an overall decrease of -0.2% m/m, versus the revised +0.5 m/m reading seen in May (prev. +0.4% m/m), above market expectations for a -0.3% m/m decrease. Despite this decrease gains were posted in 5 of 10 measured categories. Overall, the greatest sources of weakness came via average workweek, pace of deliveries, stock prices and initial jobless claims. Meanwhile, improved readings were seen from interest rate spread, money supply, consumer expectations, building permits and consumer goods orders, alongside an unchanged reading from capital goods orders. IDEA: Alongside the decrease seen in the headline measure, we continue to expect further GDP gains in 2Q10, though likely to see some deceleration to around 2.8% following the broader sense of weakness seen in recent data.

**US Initial jobless claims** for the week ending 17 July increased +37k to 464k, versus the revised 427k reading seen in the week prior (prev. 429k), above market expectations for an increase to 445k. The 4-week average was reported at 456.0k, versus the revised 454.8k seen in the previous week (prev. 455.3k).

**US June NAR existing home sales report** revealed an overall decrease of -5.1% m/m (to a SAAR of 5.37mln), versus the unrevised -2.2% m/m decrease (SAAR of 5.66mln) seen in May. This comes in above market expectations for a decrease to SAAR 5.10mln (-9.9% m/m). Meanwhile, inventories increased +2.5% to 3.992mln (8.9 months' supply), while the median price managed to post a +5.2% m/m increase to \$183.7k (+2.7% y/y).

**Housing price index for May** rose 0.5% vs. expectation of -0.3%. April was revised higher to 0.9% from 0.8%.

**NY Fed Pres Dudley(voter)** says road to US economic recovery "a bit bumpy" as relatively weak consumer spending, ongoing financial market problems weighing on recovery. Economic growth "far less robust" than Fed would like. Sees only "slight

risk" of a double-dip recession and US economic growth may be a bit less in Q3 than in 1H'10. Improving domestic, foreign demand should continue to drive us manufacturing output. Adds June payroll numbers tell story of sluggish jobs recovery.

**The Treasury** has announced the sale of 2Yr notes (\$38.0bln on Tuesday, 27 July), 5Yr notes (\$37.0bln on Wednesday, 28 July) and 7Yr notes (\$29.0bln on Thursday 29 July) with settlement on Monday, 2 August. These estimates are roughly in line with expectations with the 5Yr coming in around \$1.0bln more than some estimates.

**Canada's Monetary Policy Report: BOC** worried about European debt crisis and uneven global recovery making outlook highly uncertain. It revised its GDP forecasts lower for the next few quarters: Q2 to 3% from 3.8%; Q3 to 2.8% from 3.5%; Q4 to 3.2% from 3.5%; Q1 2011 to 3% from 3.3%; and the rest of quarters will be higher than previously forecasted. Inflation will remain mild and BOC expects the loonie to weaken; thus, helping its export growth in 2010 and 2011.

**BOC Carney** says he doesn't expect Canadian households to increase savings; believes in the quality of Statistics Canada, despite the changes it is making, but will look at the integrity of the proposed changes; doesn't believe in double dip for the US; BOC is not preordained in interest rate moves.

**Canadian retail sales** down -0.2% in May m/m vs. expectation of +0.4%. April was revised lower to -2.2% from -2%. Less autos, sales declined -0.1% m/m. compared to expectation of +0.5%. April was revised lower to -1.4% from -1.2%. The big decline came from building material and garden equipment and supplies dealers, which fell 4.1%. Gasoline stations sales were down 2.3%, as prices fell at the pump. Sales at motor vehicle and parts dealers decreased 0.5% in May. The largest percentage increase came from clothing and clothing accessories stores (+2.6%).

**EIA report** revealed U.S. weekly natgas stocks up 51 bcf, versus forecast of 53 bcf build. Natgas producing region up 6 bcf in latest week while consuming region east up 41 bcf, west up 4 bcf.

**Crude** closed the day up \$2.74 that is 3.58% higher to settle at \$79.30 a barrel as some of the upbeat corporate earnings reports brought optimism to the investors on higher demand for crude.

**Eurozone industrial orders** jumped by 3.8% m/m in May, following a downwardly-revised 0.6% gain the previous month and confounding expectations of a slight decline. The y/y rate rises to 22.7% from 21.9%. IDEA: While this is somewhat dated data, even today's PMIs corroborate unexpectedly healthy economic prospects in the Eurozone.

**The July Eurozone sectoral PMI surveys** turn out firmer than even our own above-consensus predictions for an acceleration in the rate of activity expansion. The flash manufacturing sector PMI rises to 56.5 from 55.6 in Jun and in contrast to the market prediction of a fall to 55.2. The flash services PMI rises to 56.0 from 55.5 in Jun and in contrast to the market expectation of a fall to 55.0. As such the composite PMI rises, to 56.7 from 56.0 in Jun, vs the market consensus for a fall to 55.5.

**Preliminary German manufacturing and services sector PMIs for Jul** turn out at 61.2 and 57.3 respectively, up

from 58.4 and 54.8 respectively in Jun and far exceeding market expectations. German composite PMI thus rises to 59.3 from 56.7 in Jun. French flash manufacturing PMI falls to 53.7 from 54.8 in June whilst flash services PMI is up at 61.3 from 60.8 in Jun, taking its composite PMI up to 59.9 from 59.6.

**The French INSEE survey on industrial business confidence for Jul** shows an increase in its headline sentiment indicator to 98 from an upwardly revised 96 in Jun (prev 95), and contrary to market expectations for a fall to 94. Consumer confidence on the other hand remains at a low ebb, with the headline household sentiment indicator holding steady at -39, same as in Jun, but still in contrast with the market prediction of a deterioration to -40.

**EU Monetary Affairs Commissioner Rehn** says the EU has the means to fix any problems found in the stress tests, although the banks in need of capital should seek market funding before national rescue funds. -Bbg

**According to Reuters sources the European stress test results** may be published earlier than 16:00GMT on Friday, but no final decision yet.

**European banks** may provide breakdowns of their sovereign bond exposure when they release the stress test results, according to the CEBS. -Bloomberg.

**The IMF's European Dept published a report on the Eurozone** after talks with the EC and ECB. It said the current drive to cut government debt and spending in the region could reduce the economic growth in the coming years. It also said the euro's heavy slump since the start of the year had reduced it to roughly the right level, while record low 1% ECB interest rates should be kept in place to aid the recovery. The EZ was also at risk of suffering a credit crunch, with high-debt countries such as Greece, Italy, Portugal and Spain most in danger due the amount of people employed by SMEs, who may struggle to borrow.

**UK Jun retail sales** of 0.7% m/m exceeds the market consensus of 0.5% m/m but is not as strong as our own above-consensus prediction of 1% m/m. Nevertheless the strength of Jun sales is given additional teeth by the upward revision to the May figure to 0.8% m/m, from 0.6% previously recorded. The Jun y/y rate eases however to 1.3% from 1.7% y/y in May, due mostly to base effects. Ex-auto fuel, underlying retail sales growth is stronger, rising by 1.0% m/m.

**UK BoE Chief economist Spencer Dale** says the UK economy faces a triple whammy of higher inflation, lower growth and rising unemployment. He says living standards over the next few years will rise only "minimally". In an interview with the Independent newspaper, he said he did not expect inflation to return to its 2% official target before the end of next year, partly because of the hike in VAT. Although he acknowledged that the emergency Budget had done much to avoid the risk of a UK sovereign debt crisis and a rise in interest rates, he also acknowledged that the Budget would mean lower growth.

**The Swiss SNB's monthly report** revealed that their euro reserves more than doubled to a fresh record level in the second quarter owing to its heavy scale of interventions. SNB euro holdings soared to EUR 120.5bn from 56.4bn in the first quarter, taking the euro's share in the SNB's currency reserves to 70.5%. USD holdings rose to \$45bn from \$26.1bn, making up 21.5% of reserve assets.

## JUNE LEI AND IDEAGLOBAL GDP OUTLOOK UPDATE

The June Conference Board leading economic indicators report revealed an overall decrease of -0.2% m/m, versus the revised +0.5 m/m reading seen in May (prev. +0.4% m/m), above market expectations for a -0.3% m/m decrease. Despite this decrease gains were posted in 5 of 10 measured categories. Overall, the greatest sources of weakness came via average workweek, pace of deliveries, stock prices and initial jobless claims. Meanwhile, stronger readings were seen from interest rate spread, money supply, consumer expectations, building permits and consumer goods orders, alongside an unchanged reading from capital goods orders. Alongside the decrease seen in the headline measure, we continue to expect further GDP gains in 2Q10, though likely to see some weakness around +2.8% following the broader sense of weakness seen in recent data.

The headline measure was weighed down by declines posted in 4 of 10 measured areas, with greater downward pressure being seen in the June release. Alongside the decrease seen in the headline reading, a number of critical metrics revealed downward pressure in June, increasing prospects of further gains in the near-term. Overall, negative contributions were seen from average workweek (-0.33%), pace of deliveries (-0.26%), stock prices (-0.14%) and initial jobless claims (-0.05%). Meanwhile, positive contributions were seen from interest rate spread (+0.32%), money supply (+0.14%), consumer expectations (+0.03%), building permits (+0.05%) and consumer goods orders (+0.01%), alongside an unchanged reading from capital goods orders.

As mentioned previously, despite the weaker data seen recently, conditions remain little changed from what was seen to finish off 1Q10. At present, we anticipate further traction will be seen in the coming quarters as conditions improve further (given the prospects for further improvement seen in non-farm payrolls and ISM manufacturing/non-manufacturing readings in the coming months, coupled with gains in consumer activity). However, recent weakness, coupled with weaker conditions among many critical components portrays an economy improving in the face of headwinds. On balance, we anticipate growth to see modest further improvement to finishing off 2Q10, increasing +2.8%, likely to see some deceleration in 2H10 (+2.1% in 3Q10, +2.7% in 4Q10), before posting further gains in 2011 (+3.0-3.5% in 1H11, quarterly averages).

