

WEEKLY MARKET COMMENTARY

With many people home for the holidays and trading volume down, stocks drifted

through the final week of 2011. In the end, the Dow closed out the year up 5.53%, not bad given 12 long months of partisan gridlock in Washington and what seemed like daily alerts about the meltdown in Europe that took us to the brink of bear territory as recently as October. And the S&P 500, after a final-day dip, finished 2011 almost exactly where it began, down a miniscule .003%. Perhaps the biggest surprise of 2011 was the fact that American Treasuries not only survived the debt downgrade but also became the safe haven of choice for investors around the world (the 10-year note had a yield of 1.878% on Friday), as the United States, for all of its economic woes, weathered the year better than most of its Western peers and begins 2012 on what appears to be an upswing, at least compared to Europe.

Most of what happened last week – and it wasn't much – took place overseas as the Senate and House members were home for the holidays. With the capital all but empty, the Treasury Department took the opportunity to issue its long overdue report on China's currency, and while deciding not to officially label that country a currency manipulator, as some had hoped, did make it clear there that China had work to do yet. The administration said that China, in recent high-level meetings, had committed to accelerating the level at which its currency would appreciate, but even so the Treasury Department said the renminbi remains "substantially undervalued" and "more progress is needed." The trade gap, which is influenced by the renminbi's rate as it lowers the cost of the Chinese imports we buy and raises the costs of American exports to China, is expected to finish the year at a new high.

Perhaps more surprisingly, the Treasury Department's report reprimanded Japan for its recent steps to weaken the yen, saying we "did not support" the interventions in August and October, while adding that Japan should instead "take fundamental and thoroughgoing steps to increase the dynamism of the domestic economy."

In a bipartisan move that one can only hope signals a new spirit of compromise for 2012, the president announced two nominees for the Federal Reserve board, one from each party. It's the first time since 1988 that a president has nominated someone from the opposite side of the aisle.

The only other story from the homefront was about what was one of the least happy events of 2011, the debt-ceiling debate. Early in the week, President Obama said he would make the last adjustment permitted by the deal made on Aug. 2, raising the debt ceiling another \$1.2 trillion to \$16.4 trillion to cover our revenue shortfall (it has already been raised twice in increments of \$900 billion.) For the record, we currently borrow 36 cents for every federal dollar that's spent. The details, if not the exact total, were worked out months ago and it would be very difficult for Congress to block the step – it would require both chambers to vote against it and then override a presidential veto. In any case, the president later agreed to put



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Key Market Data

	week ending...	12/23/11	12/30/11	Change
Down Jones Industrial Average Index		12,294.00	12,217.56	-0.62%
S&P 500 Index		1,265.33	1,257.60	-0.61%
NASDAQ Composite Index		2,618.64	2,605.15	-0.52%
10-Year Treasury Note Rate		2.026%	1.878%	-0.148 pct. pts.
NYMEX Crude Future (Barrel)		\$99.68	\$98.83	-0.85%
Euro/U.S. Dollar		\$1.3046	\$1.2960	-\$0.0086

off the decision until Congress returned in mid-January, which means the move will not go quietly even as it's likely to be approved, with the GOP getting another chance to talk about the president's profligate spending and the Democrats beating the tax-the-rich drum. Welcome to the election year in earnest.

Even in a quiet week, there was plenty of loud news from Europe that helped drive the euro to a 15-month low against the dollar.

In Italy, Prime Minister Mario Monti unveiled yet another plan, this one called "Grow Italy," to spur competition and growth, in part by updating the country's backwards infrastructure, modernizing its guilds and overhauling its labor rules. Some of the ideas had been in his earlier austerity plan but they were removed because of pushback from Parliament, and it remains to be seen if they'll sell a second time around. Monti's goal is to present a concrete plan for economic reform and growth to eurozone leaders when they next meet in Brussels on Jan. 23.

At midweek, all eyes were on Italy's sale of short-term bonds, which went better than expected as it sold €9 billion (\$11.8 billion) in six-month bonds at a yield of 3.251% compared to 6.504% in November, though most analysts agreed that the sale's success largely reflected the new and lower borrowing rates on three-year loans recently offered by the European Central Bank. The real test came later in the week when Italy tried to sell 10-year notes and it did not go as well, with only €7 billion (\$9 billion) in bonds sold whereas Italy was hoping to sell €8.5 billion (\$11 billion). As a result, the yield on the 10-year was back up to 7%, considered to be the crisis line.

Even so, in his year-end speech, Monti said Italy was back "from the edge of the precipice" and tried to instill confidence by describing himself as the "most German of Italian economists." He went on to say that it was unreasonable that the yield on Italy's 10-year issue was back at 7% and also called on his fellow eurozone leaders to make the bailout fund "significantly bigger."

As expected, Spain's new government said it wasn't going to come close to its budget target for this year and announced tax increases of €15 billion (\$19.4 billion) to partially address the shortfall (spending cuts have also been proposed.) Earlier in the year, Spain had committed to a deficit that was 6% of total GDP and the total is now going to be closer to 8%. Spain is also not expected to reach its budget target for 2012 of 4% of GDP, but Mariano Rajoy, the new prime minister, is reportedly going to unveil a more comprehensive budget-cutting plan later this month. Much of Spain's trouble is attributed to the fact that it has 17 economically autonomous regions and the federal government has no control over their budgets.

In other economic news, the receipts for the holiday spending season were beginning to come in and the numbers were strong, especially online. The market research firm comScore reported that online sales between Nov. 1 and Dec. 26 were \$35.3 billion, up 15% from a year earlier. And for the second year in a row, Cyber Monday, the Monday after Thanksgiving, was the biggest day of the year for online sales, with consumers shelling out \$1.3 billion, a 22% increase from 2010. Overall retail sales, according to the International Council of Shopping Centers, were up 3.8% over the same period.

There was also more positive news from the jobs front where, despite a slight increase in first-time jobless claims to 381,000, the four-week moving

average hit a three-and-a-half-year low at 375,000.

The National Association of Realtors said the number of Americans who signed contracts to buy homes rose 7% in November from October to its highest level in a year and a half, and the figure was up 5.9% from a year earlier.

And the Conference Board's consumer confidence index for December increased to 64.5 from 55.2 in November, its highest point since June.

On a less positive note, the Standard & Poor's/Case-Shiller home price index for October was down 1.2% from the month before, with 19 of the 20 cities tracked showing declines – Atlanta and Las Vegas hit new lows while only Phoenix was up, and that a modest 0.3%. Overall, the index was off 3.4% from last October.

Lastly, because of poor holiday sales, Sears, the venerable but struggling retailer, announced it was going to close 120 stores that had been on the brink.

A Look Ahead

As we wait to see what the first week of the new year will bring, there will be a number of releases to set the tone, including the latest on factory orders, construction spending, chain store sales and vehicle sales. The Institute of Supply Management will update its manufacturing and non-manufacturing indexes, and the Federal Reserve will release the minutes from its last meeting of 2011 back on Dec. 13. Then on Friday, the Labor Department will announce the unemployment rate for December which, given the recent weekly totals, should represent a strong finish for 2011 by staying at or near November's rate of 8.6%.



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Please remember that all investments carry some level of risk, including the potential loss of principal invested. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance and are not indicative of any specific investment. Diversification and strategic asset allocation do not assure profit or protect against loss. Although stocks have historically outperformed bonds, they also have historically been more volatile. Investors should carefully consider their ability to invest during volatile periods in the market. The securities of small capitalization companies are subject to higher volatility than larger, more established companies and may be less liquid. Bond investors should carefully consider risks such as interest rate risk, credit risk, securities lending, repurchase and reverse repurchase transaction risk. Greater risk is inherent in investing primarily in high yield bonds. They are subject to additional risks, such as limited liquidity and increased volatility. There is an inverse relationship between interest rates and bond prices. Investing in foreign securities is subject to certain risks not associated with domestic investing such as currency fluctuations and changes in political and economic conditions.

All index references and performance calculations are based on information provided through Bloomberg. Bloomberg is a provider of real-time and archived financial and market data, pricing, trading, analytics, and news.

The Dow Jones Industrial Average Index® is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Standard and Poor's 500 Index® (S&P 500®) is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Standard & Poor's offers sector indices on the S&P 500 based upon the Global Industry Classification Standard (GICS®). This standard is jointly maintained by Standard & Poor's and MSCI. Each stock is classified into one of 10 sectors, 24 industry groups, 67 industries and 147 sub-industries according to their largest source of revenue. Standard & Poor's and MSCI jointly determine all classifications. The 10 sectors are Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services and Utilities.

The NASDAQ Composite Index® Stocks traded on the NASDAQ stock market are usually the smaller, more volatile corporations and include many start-up companies.

NASDAQ - National Association of Security Dealers Automated Quotations. The NASDAQ is a computer-operated system owned by the NASD that provides dealers with price quotations for over the counter stocks.

Bear market calculations and interpretations are derived from data supplied by Ned Davis Research, Inc.

The European Central Bank (ECB) is the institution of the European Union (EU) which administers the monetary policy of the 17 EU eurozone member states.

comScore is a marketing research company that provides marketing data and services to many of the Internet's largest businesses.

The International Council of Shopping Centers (ICSC) is the global trade association of the shopping center industry with 60,000 members worldwide. ICSC links with more than 25 national and regional shopping center councils throughout the world.

The National Association of Realtors (NAR) is a real estate trade association involved in all aspects of the residential and commercial real estate industries. NAR also functions as a self-regulatory organization for real estate brokerage.

The Conference Board Leading Economic Index is intended to forecast future economic activity and is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of 10 key variables. These variables have historically turned downward before a recession and upward before an expansion.

The S&P/Case-Shiller Home Price Indices are designed to be a reliable and consistent benchmark of housing prices in the United States. Their purpose is to measure the average change in home prices in a particular geographic market. They are calculated monthly and cover 20 major metropolitan areas.

The Institute for Supply Management is a not-for-profit U.S. association for the benefit of the purchasing and supply management profession, particularly in the areas of education and research.