

# WEEKLY MARKET COMMENTARY

## The first week of 2012 was a promising one, as all three of the major stock indexes

were up and strong reports about jobs and car sales indicated that while the American economy may not yet be where it was before the Great Recession began, it's on far firmer ground going into the new year than that of Europe.

Though the Dow was down for the day, the most upbeat news came on Friday when the Labor Department announced that the economy added 200,000 jobs in December – 212,000 in the private sector – which drove the unemployment rate down from an upwardly revised 8.7% in November to 8.5%, its lowest level in almost three years. It was also the sixth month in a row that over 100,000 jobs were added. And the underemployment rate, which includes those who have stopped looking for work or prefer full-time work over part-time work, fell to 15.2% (it was at 16.6% a year ago.) However, in an election year no statistic is clear cut, and some were quick to point out that the biggest boost came from temp jobs during the holiday season which would soon end, and that the percentage of employed Americans remained stubbornly low at 64%. President Obama was pointedly low key about the news, saying, “We have made some real progress. Now is not the time to stop.”

Earlier in the week, the president had been far more politically assertive, irking the GOP by appointing Richard Cordray as the head of the new Consumer Financial Protection Bureau while Congress was on recess. The Republicans were more than peeved – they were threatening a lawsuit. And Mr. Cordray himself took a hardline on day one, saying, “The consumer bureau will make clear that there are real consequences to breaking the law” for any financial firms that mislead the public.

What politicians can do to salvage their reputation with the public remains an open question, but based on a *Wall Street Journal*/NBC News poll conducted in December, they need to do something, as 42% of the respondents said that the current Congress was the worst ever.

The Federal Reserve was in the news on a couple of fronts last week. First, there was the release of the minutes of the Fed's last meeting of 2011 which further opened the window on the plans of the once sphinx-like body to make its policy moves even more transparent. Starting with the next meeting on Jan. 25, the Fed will publish the predictions of its board members about their decisions, the hope being to better guide investors – and enhance its influence. The decision was made at the previous meeting but not announced until Tuesday. The first forecast will reveal the predictions that board members made about the level of short-term interest rates in the fourth quarter of 2012, 2013 and 2014. The Fed will also address when it might raise its rate and any plans for its investment portfolio. One plus: if banks are convinced that the rate will hold, they may lower borrowing costs for consumers (though those rates may not have much lower to go). The minutes also indicated that “a number of members” are considering further financial action along the lines of QE1 and QE2 and believe that



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### Key Market Data

week ending...	12/30/11	1/6/12	Change
Down Jones Industrial Average Index	12,217.56	12,359.92	1.17%
S&P 500 Index	1,257.60	1,277.81	+1.61%
NASDAQ Composite Index	2,605.15	2,674.22	+2.65%
10-Year Treasury Note Rate	1.878%	1.961%	+0.083 pct. pts.
NYMEX Crude Future (Barrel)	\$98.83	\$101.56	+2.76%
Euro/U.S. Dollar	\$1.2960	\$1.2719	-\$0.0241

any such steps “would be more effective if accompanied by enhanced communication,” which some saw as an indication that further intervention by the Fed was in the offing.

Then, despite the fact that the Fed’s official role is restricted to jobs and inflation, it took the unusual step of issuing a whitepaper that it sent to Congress – followed up by speeches by three top Fed officials – calling for Congress and banks to take more action to address the housing crisis. The report said that if no action was taken, “the adjustment process will take longer and incur more deadweight losses, pushing housing prices lower and thereby prolonging the downward pressure on the wealth of current homeowners and the resultant drag on the economy at large.”

As noted, there were a number of other positive reports about the American economy. The American auto industry, stalwart all year, closed out 2011 with a bang. In December, sales improved for the seventh straight month, climbing 8.7% to 1.2 million vehicles sold, and the annualized sales rate was 13.56 million vehicles. Sales for all of 2011 were up 10% from 2010 and, all told, 12.8 million vehicles were sold, making it the best year since 2008 (before the recession, the average was about 16 million.) For December, Chrysler’s sales jumped 37% from the previous year, Ford 10% and GM 4.6% – and Ford and GM were the only companies to break the 200,000 vehicles sold mark for the month. For the year, Chrysler’s sales were up 26%, GM 13% and Ford 11%. According to Edmunds.com, the Big Three, GM, Ford and Chrysler, all increased their market share in the same year for the first time in 20 years and U.S. automakers grabbed 47% of the total market last year, up from 45% in 2010. Forecasts for the coming year are in the 13.6 million range. Even so, some analysts said that the performance by American automakers would be hard to repeat because of a sharper focus on the American market by foreign car makers thanks to the downturn in Europe and because of an anticipated rebound by Japan’s automakers from last year’s earthquake.

The Institute of Supply Management said its manufacturing index increased to 53.9 from 52.7 in November, the fastest rate in six months and its best reading since June. The ISM also reported that factories hired at their best clip since June and exports were up. And its nonmanufacturing index rose 0.6% in December to 52.6.

The Commerce Department announced that construction spending was up 1.2% in November to a seasonally adjusted annual rate of \$807.1 billion after falling 0.2% the month before, representing the biggest jump since August. It also said that factory orders in November increased 1.8%, the best rate in four months, after being off 0.2% in October. Orders for durable goods rose 3.7%.

And Thomson Reuters reported that same-store sales in December were up 3.4% from a year earlier, slightly above expectations, though some analysts discounted the increase as the product of deep price cuts, and the rise did not therefore indicate a sustainable spike in consumer spending.

In Europe, a number of releases confirmed a steady economic slowdown and a decline in consumer confidence. The euro celebrated its 10th anniversary on Jan. 2, and Europeans ushered in the new year with grim words that made some wonder if the currency would make it to 11. For example, on New Year’s Eve, Germany’s Angela Merkel told her constituents “next year will no doubt be more difficult than 2011,” whereas last year she had told Germans they were “mastering the crisis as no other nation.” And in Greece, Prime Minister Lucas Papademos told his countrymen they needed to be

resolute and see through the reforms that lay ahead “so that the sacrifices we have made up to now won’t be in vain.” A few days later, he sounded a more alarming note, saying that the second bailout was “exceptionally crucial” and “in the coming weeks, everything will be decided.”

By the end of the week, the yield on the Italian 10-year bond was over 7% and Spain’s was up from 5% last month to 5.64%. To put into perspective why that’s so alarming, consider this: Europe needs to refinance over €1 trillion (\$1.29 trillion) of debt in 2012. At the same time, the euro fell further against the dollar while the yield on our 10-year issue remained below 2%.

In a rare piece of good news, annual inflation in the eurozone fell to 2.8% in December from 3% the month before, perhaps giving the European Central Bank some much needed wiggle room with its short-term rate. Meanwhile, in a move that surprised ECB watchers, the bank chose as its new chief economist a Belgian, Peter Praet, to a position that’s usually held (and was last held) by a hard-line German. His predecessor, the German Jürgen Stark, resigned because he thought the bank was getting too involved in the purchase of bonds.

Finally, the price of oil moved back up past the \$100 a barrel mark as Iran squared off against Europe and the United States over all oil exports moving through the Straits of Hormuz and over current and proposed sanctions against Iran to curb its development of nuclear weapons. So far, it’s mostly been posturing, but one fifth of the world’s oil supply passes through the Strait, and industry analysts estimate that its closing would drive the price of a barrel up to \$150 in a matter of a week or two – not the jolt the world’s economy needs right now.

## A Look Ahead

Most Americans will be watching what unfolds in New Hampshire this week as Mitt Romney tries to get a stranglehold on the Republican nomination for president, which would signal an end to the contenders going after each other, as the GOP would turn its full attention to the president and his fellow Democrats – cover your ears. There will also be a number of key releases, including the latest on wholesale and business inventories, retail sales and the trade balance. The Fed will release its Beige Book report, a snapshot of the economy in its 12 regions. And some believe that this will be the week when the ratings agencies downgrade France’s AAA rating, a move that France’s President Nicolas Sarkozy has been preparing his nation for but one that may nonetheless rile the markets.



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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.

Quantitative easing (QE) is an unconventional monetary policy used by central banks to stimulate the national economy when conventional monetary policy has become ineffective. QE1 is a nickname developed to refer to the first round of quantitative easing the Fed launched to promote stronger growth in America post financial crisis of 2008. QEII is the Federal Reserve's second attempt at quantitative easing. Proposed in November 2010, it was designed to bring \$600 billion to the U.S. economy in order to ease pressure on banks and other financial institutions.

Edmunds.com, Inc. publishes websites that empower, engage, and educate automotive consumers, enthusiasts, and insiders in the United States.

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. The ISM Index tracks the amount of manufacturing activity that occurred in the previous month. A value below 50 tends to indicate an economic recession, especially if the trend continues over several months. A value above 50 tends to indicate economic growth.

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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.

The Federal Reserve Beige Book is published eight times per year and includes anecdotal information on current economic conditions in its 12 districts through reports from Bank and Branch directors and interviews with key business contacts, economists, market experts and other sources.