

# WEEKLY MARKET COMMENTARY

## It says something about the renewed confidence in the state of the American economy -

especially compared to that of the eurozone – that the Dow’s three-week winning streak ended because the 2.8% GDP growth in the fourth quarter was below expectations, despite being the best quarter of 2011. But even as the Dow dipped, the S&P 500 and the NASDAQ maintained their streaks and all three indexes are well up for 2012: the Dow has gained 3.63%, the S&P 500 4.67%, and the NASDAQ 8.11%. There has also been – so far, anyway – less volatility in the new year, with the Dow now having gone 17 days without a loss or gain of 100 points, the longest such run since December 2010.

Last week’s news was also different in that most of the headlines came from the home front for a change, rather than Europe, what with the president’s State of the Union speech, the Federal Reserve’s first meeting of 2012 and, as noted, the Commerce Department’s report on economic growth.

The president went before Congress on Tuesday night and set the tone for the upcoming election by taking a firm stand against what he sees as the economic inequality in America. He pledged that the American economy would be “built to last” and that he’d use his office to close the gap between the rich and the rest of America, describing the nation as a place “where everyone gets a fair shot, everyone does their fair share, and everyone plays by the same set of rules.” He called for the adoption of the “Buffett Rule” which would see America’s millionaires pay an effective tax rate of 30%. And, as expected, he proposed eliminating tax credits for companies that move jobs overseas and creating them for companies that bring jobs back. He also suggested using money saved from the war in Iraq to fund public works projects, and he promised to put further heat on companies that had engaged in abusive mortgage lending practices. Unfortunately, he declined to address the outstanding budget deficit in any concrete manner.

The president’s speech came right after Mitt Romney decided to release his tax return for 2010 which showed an effective tax rate of less than 15% on his millions in income. President Obama’s income in 2010 was one-tenth of Romney’s but his tax rate was double.

The next day, the Fed indicated that it will keep its benchmark rate near zero until at least 2014 and also signaled that it could get back into the bond buying business if the recovery floundered because of low inflation. Fed Chairman Benjamin Bernanke said there was a “very strong case” for a third round of quantitative easing “if the recovery continues to be modest and progress on unemployment very slow and inflation appears likely to be below target for a number of years out.” The meeting also marked a new era of transparency with the Fed releasing the board member’s long-range economic forecasts. The hope is that by letting people know more about the thinking behind short-term interest rates, long-term rates will also fall, leading to lending and spending. In other action, the Fed officially adopted a target of 2% for long-term inflation, a first. However, in his post-meeting



Emmett Wright, CFA  
Chief Investment Officer  
Northwestern Mutual  
Wealth Management Company

### Key Market Data

week ending...	1/20/12	1/27/12	Change
Dow Jones Industrial Average Index	12,720.48	12,660.46	-0.47%
S&P 500 Index	1,315.38	1,316.33	+0.07%
NASDAQ Composite Index	2,786.70	2,816.55	+1.07%
10-Year Treasury Note Rate	2.028%	1.896%	-0.132 pct. pts.
NYMEX Crude Future (Barrel)	\$98.46	\$99.56	+1.25%
Euro/U.S. Dollar	\$1.2931	\$1.3219	+\$0.0288
MSCI EAFE Index	1,472.05	1,495.58	+1.59%

news conference, another recent innovation, Mr. Bernanke said he would not be against letting inflation rise higher if it helped reduce unemployment: “We’re not absolutist,” he said. The Fed also put GDP growth for 2012 at 2.2-to-2.7%, down from its previous forecast of 2.5-to-2.9% in part because of the effect of “strains in global financial markets.”

On Friday, the Commerce Department announced that the economy gained 2.8% in the fourth quarter, the fastest pace in 18 months and well up from 1.8% in the third quarter. Even so, there’s consensus that the rate will taper off this quarter (and also that the president’s chances for reelection will in large part hinge on the rate over the next two quarters, along with the unemployment rate). The growth was largely the result of companies restocking inventories, not consumer spending, and the one may tail off if the other doesn’t pick up. Consumer spending was up 2% after rising 1.7% in the third quarter. By comparison, investment in real estate, equipment and software, and inventories jumped 20%. Spending at the federal, state and local levels dropped 4.6% last quarter and it’s unlikely to go up anytime soon. For the year, the economy gained 1.7% compared to 3% in 2010. Economists estimate that the failure to renew the Social Security payroll tax break, now slated to expire on Feb. 29, would lop a full percentage point off GDP in 2012.

As the report came out, the latest *Wall Street Journal*/NBC News poll found that, for the first time in seven months, President Obama had a positive approval rating, 48% versus 46% that disapprove. The *Journal* quoted Bill McInturiff, a GOP pollster, as saying, “Republicans had better bring their A game to the election in November as today’s results are a reminder that as attitudes about the economy improve, so does President Obama’s standing.”

As expected, the Senate voted to approve the \$1.2 trillion rise for the debt ceiling by a vote of 52 to 44. The total is now \$16.4 trillion. The House, which had rejected the hike, passed a “resolution of disapproval” but the Senate refused to take it up. Senator Max Baucus (D - Mont.), the chairman of the Senate Finance Committee, put it bluntly: “Increasing the debt limit permits the Treasury Department to pay the bills we have already incurred.”

As for Europe, finance ministers met in Brussels and worked to square away the details on the new bailout fund while also putting pressure on creditors to finish up their “voluntary” restructuring of Greece’s debt, lobbying for the reissued bonds to have an interest rate of less than 4%. Once the deal is finalized, Greece will get enough money from the fund to stave off default, for 2012 anyway. But the talks of restructuring Greek debt have stalled. The main issue is trying to keep the compensation that will be paid to creditors down as it’s the rest of the eurozone, not Greece, which will pick up the tab. The European Central Bank, by the way, has €55 billion in Greek bonds and even though it’s not part of the “voluntary” deal, it could be staggered if Greece goes under.

The bailout fund is expected to be in place by July and the plan is to replace the current, temporary fund, the €440 billion European Financial Stability Facility – some of which has already been doled out to Greece, Portugal and Ireland – with a permanent fund, the European Stability Mechanism, of about €500 billion. Christine Lagarde, the president of the International Monetary Fund, is pushing for a fund of €750 billion. She described the current crisis as a “1930s moment” and said the failure to act could lead to a “downward spiral that could engulf the entire world.” Lagarde is worried that the continued austerity pushed by Germany will strangle growth across the eurozone. “The longer we wait,” she said, “the worse it will get.”

The IMF also issued a report in which it said that it had lowered its estimates for global economic growth in 2012 from the 4% forecast in September to 3.25% (after 3.8% last year) because the euro has entered “a perilous new phase.”

And while Greece is trying to nail down the debt renegotiation, the IMF released data that shows Greece’s debt is now at 160% of GDP with no prospects for growth – its economy lost an estimated 6% in 2011 and it is forecast to fall another 5% this year. The IMF’s participation in the bailout was contingent on Greece reducing its debt to 120% by 2020, but the IMF now figures the figure will be no lower than 135%. Further, the budget deficit for 2011 is expected to rise as high as 10% whereas the target was 8%. Stay tuned.

In the opening address at the World Economic Forum in Davos, Switzerland, Germany’s Chancellor Angela Merkel took her usual cautious tone, not offering any new ideas or giving in to the pressure that Germany should do more to bolster the bailout fund, saying, “What we don’t want is that we promise something that we can’t deliver.” She also said, “We are not going to resolve this with a wave of a magic wand.”

Treasury Secretary Timothy Geithner, also in Davos, said the major threats to U.S. economic growth in 2012 were not domestic but the crisis in Europe and the possibility of further tensions with Iran which could lead to a spike in oil prices.

As it happens, the European Union turned up the pressure on Iran last week, saying it would ban oil imports starting July 1 if Iran didn’t abandon its nuclear ambitions. Europe, the largest buyer of Iranian oil makes up about 20% of Iran’s oil revenues. Iran said it would turn to its number two purchaser, China, to sell more – China has so far refused to take part in any embargo. Iran, characteristically combative, also said it may respond to Europe’s threatened oil embargo by cutting off oil exports first.

Despite the recent credit rating downgrades, investors are pouring money into the government bonds of nations such as France and Austria which are no longer AAA. In fact, French and Austrian securities have beat AAA-rated company debt since the two nations were deprived of the highest ranking on Jan. 13. And U.S. Treasuries have returned three times as much as AAA corporate bonds since our rating was cut by a notch last August. The situation may change if Moody’s Investors Services and Fitch Ratings follow S&P, forcing funds required to hold only AAA assets to cut their investments.

In Great Britain, GDP fell 0.2% in the fourth quarter, putting it on track for recession despite efforts to check spending and stimulate the economy. The U.K.’s GDP is also forecast to fall in the current quarter, which would make it an official recession for the first time since 2009. And the unemployment rate in Spain rose to 22.85% in the fourth quarter, more than double the average rate for the European Union.

In other news, the Thomson Reuters/University of Michigan consumer confidence index rose to 75 in January from 69.9 in December, its highest level since February of last year.

Apple, driven by the Christmas frenzy for iPhones and iPads, doubled its fourth-quarter profits from a year earlier to \$13.1 billion – and the iPhone 5 hasn’t hit the market yet. And the anticipation is building as rumor has it that Facebook may file for its IPO as early as this week. The firm is expected

to end up with a value of at least \$75 billion.

The sale of new homes fell in December for the first time in four months, down 2.2%, closing out the worst year on record: 302,000 sales (record-keeping began in 1963).

The Commerce Department said that orders for durable goods improved 3% in December, largely driven by orders for aircraft parts.

The Conference Board reported that its index of leading indicators was up 0.4% to a five-month high.

Finally, yields on U.S. Treasuries continued to fall, with five-year and seven-year issues both hitting record lows at 0.752% and 1.359%, respectively.

## A Look Ahead

This week will be a busy one for politicians and investors. European leaders will meet in Brussels today and then tomorrow American voters will go to the polls in Florida's GOP primary. Releases will include the latest on personal income and spending, the Standard & Poor's/Case-Shiller Home Price Index, construction spending, factory orders, vehicle and chain store sales, and the ISM's manufacturing and nonmanufacturing indexes. The most watched release will come on Friday when the Labor Department announces the unemployment rate for January, expected to remain unchanged at 8.5%.



**Emmett Wright, CFA**  
Chief Investment Officer  
Northwestern Mutual Wealth Management Company

---

Emmett Wright is the Chief Investment Officer of The Northwestern Mutual Wealth Management Company. The opinions expressed are those of Emmett Wright as of the date stated on this report and are subject to change. There is no guarantee that the forecasts made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment or security. Information and opinions are derived from proprietary and non-proprietary sources.

Northwestern Mutual Wealth Management Company, Milwaukee, WI, is a subsidiary of The Northwestern Mutual Life Insurance Company, Milwaukee, WI (NM) and a limited purpose federal savings bank authorized to offer a range of financial planning, trust, fiduciary, investment advisory and investment management products and services. Securities are offered through Northwestern Mutual Investment Services, LLC, subsidiary of NM, broker-dealer, registered investment adviser, member FINRA and SIPC.

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<sup>®</sup> 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<sup>®</sup> (S&P 500<sup>®</sup>) 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<sup>®</sup>). 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<sup>®</sup> 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.

The 10-year Treasury Note Rate is the yield on U.S. Government issued 10-year debt.

NYMEX Crude Future is the futures price on a barrel of oil on the New York Mercantile Exchange.

Euro/U.S. Dollar is the currency exchange rate between the Euro and the U.S. Dollar.

The MSCI EAFE Index measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia and the Far East.

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.

The International Monetary Fund (IMF) is the intergovernmental organization that oversees the global financial system by following the macroeconomic policies of its member countries, in particular those with an impact on exchange rate and the balance of payments.

The World Bank is an international financial institution that provides loans to developing countries for capital programs. It is made up of two unique development institutions owned by 187 member countries: the International Bank for Reconstruction and Development (IBRD) aims to reduce poverty in middle-income and creditworthy poorer countries, while the International Development Association (IDA) focuses on the world's poorest countries.

The U.S. Department of Labor Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output.

The U.S. Department of Labor Consumer Price Indexes (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

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.

Freddie Mac is a stockholder-owned corporation chartered by Congress in 1970 to create a continuous flow of funds to mortgage lenders. Freddie purchases single-family and multi-family residential mortgages and mortgage-related securities, which it finances primarily by issuing mortgage pass through securities and debt instruments in the capital markets.

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.

61-1200