

WEEKLY MARKET COMMENTARY

On Friday, the jobless rate unexpectedly fell to 8.3%, its lowest level in three years.

That same day, investors responded by driving the Dow back to where it was in mid-May of 2008, before the recession began. The Dow wasn't alone. The NASDAQ is now at its highest point in over a decade, since December 2000. And while the S&P 500 has yet to get back to where it was before Lehman Brothers collapsed, it has gained 6.9% so far this year, its fastest start since 1987.

In fact, stocks had their best month in January since 1997 and also showed, based on the lack of volatility, that investors may come to accept the drama in Europe as a constant: the S&P 500 had its quietest January since 1997 as the index moved by 1% or more only twice, and both times it went up, while the Dow only swung 100 points or more once in January. The S&P gained 4.4% for the month and, for stat nuts, *The Wall Street Journal* reported that since 1950, in the 38 years when the S&P 500 has finished up for January, it has been in the black for the entire year 34 times. The Dow climbed 3.4%, its best January since 1997, and the NASDAQ added 8%.

While November is a long, long way off, the news about jobs shifted the political equation – for this week, anyway. *The New York Times* may have overstated the case with its page one headline, “Jobless Rate Falls to 8.3%, Altering Face of Campaign,” but even the editorial page of *The Wall Street Journal* conceded, “Only a curmudgeon would deny the good news.” The president was careful not to crow, saying that “the recovery is speeding up” but cautioned, “These numbers will go up and down in the coming months.” Mitt Romney, the presumptive GOP presidential candidate after his win in Nevada, said, “We can do better,” adding, “This president has not helped the process. He’s hurt it.”

Politicking aside, the fact remains that while Europe teeters on the brink of a new recession, or worse, the recovery in America remains on a slow but steady upswing.

The unemployment rate was expected to come in unchanged at 8.5%, but the Labor Department said that the economy gained 243,000 jobs in January, the most since last April, to fuel the rate's drop. It was the fifth consecutive decline and the rate is now at its lowest point since February 2009, President Obama's first full month in office (it was at 7.8% when he became president.) That said, there are still 12.8 million Americans out of work and 5.5 million of them have been jobless for six months or more. For the record, the Federal Reserve recently said it expected the jobless rate to be between 8.2% and 8.5% this year.

Speaking of the Fed, its chairman, Benjamin Bernanke, was on Capitol Hill before the House Budget Committee where the Republican members took aim at him for getting involved in the housing and jobs markets since, officially, the Fed's lone mandate is to manage inflation. Paul Ryan (R - Wis.), the committee's chairman, took Mr. Bernanke to task for the Fed



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Key Market Data

week ending...	1/27/12	2/3/12	Change
Dow Jones Industrial Average Index	12,660.46	12,862.23	+1.59%
S&P 500 Index	1,316.33	1,344.90	+2.17%
NASDAQ Composite Index	2,816.55	2,905.66	+3.16%
10-Year Treasury Note Rate	1.896%	1.943%	+0.047 pct. pts.
NYMEX Crude Future (Barrel)	\$99.56	\$97.84	-1.73%
Euro/U.S. Dollar	\$1.3219	\$1.3159	-\$0.0060
MSCI EAFE Index	1,495.58	1,529.46	+0.716%

having recently pledged to keep its benchmark rate at near zero well into 2014, saying, “I think this policy runs the great risk of fueling asset bubbles, destabilizing prices and eventually eroding the value of the dollar.” Mr. Bernanke stuck to his guns while again prodding Congress to address “the urgent issue of fiscal sustainability.”

In more sobering news about the economy and jobs, the nonpartisan Congressional Budget Office (CBO) said the budget deficit would be over \$1 trillion in 2012 for the fourth year straight, not a streak anyone was hoping for – it was \$1.1 trillion in 2011, down about \$200 billion from 2010. It will then fall sharply because of tax increases and budget cuts that have already been mandated. The CBO also said that it expected the unemployment rate to reach 8.9% in the fourth quarter of 2012 and hit 9.2% by the last quarter of 2013. Douglas Elmendorf, the director of the CBO, said, “We have not had a period of such persistently high unemployment since the Depression.” Economic growth, adjusted for inflation, was forecast to be 2.3% this year if the Social Security payroll tax cut was extended but only 1.1% in 2013. This year’s deficit would equal 7% of GDP, almost two percentage points lower than last year but still, according to the CBO report, higher than any deficit between 1947 and 2008. The deficit as a percentage of GDP is then expected to fall an average of 1.5% a year through 2022. Finally, the CBO said we would have to borrow \$21.6 trillion by 2022, well above the current debt ceiling, and net interest payments would triple to \$624 billion. “The longer that we wait as a country to make the sort of choices that we have to make,” Mr. Elmendorf added, “the harder it will be to make them.”

The president announced a new mortgage relief plan, acknowledging that previous plans had not worked while trying to explain why this one would be different. The plan’s goal is to give “every responsible American” the chance to refinance and save around \$3,000 a year by taking advantage of the historically low rates even if they are underwater. “No more red tape,” the president said, “No more runaround from the banks.” The proposal, which has to clear Congress, is designed to help out some of the more than 10 million Americans who are underwater, paying a mortgage that exceeds the value of their home. Speaker of the House John Boehner (R - Ohio) responded to the plan by saying, “One more time? One more time? How many times have we done this?”

In the Senate, there was a rare moment of bipartisanship when it passed a ban on insider trading – officially, the “Stop Trading on Congressional Knowledge Act” – by a vote of 96 to three. The House will vote on the bill this week.

As many pundits and prognosticators have noted, the recovery – and with it the president’s hopes for reelection – are inextricably linked to what’s happening in Europe. On Monday, European leaders met in Brussels and agreed to adopt a new fiscal compact to enforce tougher budget discipline, though no tangible steps were taken to address the debt crisis or the crumbling economy. Of the 27 European Union members present, only Great Britain and the Czech Republic voted no. Britain’s Prime Minister David Cameron not only rejected the plan, but rubbed salt in the wound, saying, “Our national interest is that these countries get on and sort out the mess that is the euro.” The compact will go into effect once it’s ratified by 12 eurozone members. Its terms stipulate fines for any nation whose deficit averages more than 0.5% of GDP over a full economic cycle – good luck – and legally restrict companies in dire economic straits from using fiscal stimulus. Its passage makes it clear that Germany is in the driver’s seat while leaders such as Cameron and Italy’s Prime Minister Mario Monti have insisted that further austerity will be a deathblow for the euro, not a

cure. Germany's Chancellor Angela Merkel had a slightly different take, saying, "Considering the timeframe, this was a real masterpiece."

Greece continued to work with its creditors to renegotiate its debt to private bondholders, seen as essential to its survival – and a prerequisite of it getting a second bailout. The Germans also said that if Greece didn't show that it can get its economy together and hit the benchmarks it has pledged to reach, it might not get any more bailout money unless countries such as Germany got more involved as caretakers. After the summit on Monday, Merkel said that Greece, unlike Portugal and Ireland, "has made such supervision necessary." Greece's newspapers responded by invoking Germany's occupation in World War II, which can't have helped the debt negotiations. Even so, the leaders of Greece's coalition government pledged to take further steps to reform the economy.

At the same time, Portugal was seeing the yield on its bonds rise and trying to fight the perception that it will be the next Greece. Its economy is expected to fall 3% this year and unemployment is at 13.6%. However, Portugal's debt as a percentage of GDP is estimated to come in at only 112% this year compared to Greece at 190%, according to the International Monetary Fund (IMF).

After Brussels, Merkel was off to China where Prime Minister Wen Jiabao made a commitment, sort of, to contribute to the European Financial Stability Facility, the current bailout fund, and the European Stability Mechanism, the name of its successor fund. On Thursday, Mr. Wen said, "China supports Europe in safeguarding the stability of the euro," and it has \$3.2 trillion in foreign reserves to back up that support. The concern was that, in exchange, the Chinese would insist that Europe remove trade barriers against low-priced Chinese goods or allow shipments of weapons to China that are currently prohibited. There was also a rumor that China would only loan money through the IMF and would insist that the IMF accept any liability for default on the loan. On Friday, there was some qualifying, with Mr. Wen assuring the world that China was not out to buy Europe: "This is a concern and doesn't fit reality," said Mr. Wen, "China doesn't have this intention and doesn't have this ability."

The eurozone's GDP fell to 1.5% in the fourth quarter while unemployment remained unchanged but at a 13-year high of 10.4%. Germany was at one end, with its rate dropping to 5.5%, a low since it adopted the euro, while Spain was at the other, with its jobless rate up to 22.9%.

In other news, the Commerce Department said that the income of Americans rose 0.5% in December, the biggest increase since March, but the savings rate was also up to 4% from 3.5%, so that extra money wasn't being spent. For all of 2011, the savings rate fell to 4.4% from 5.3% in 2010.

There was a flurry of good news about global manufacturing last week, beginning with the Institute for Supply Management (ISM) saying its manufacturing index, driven by new orders, improved at its fastest pace since last June, up to 54.1 in January from 53.1 in December. China also showed a gain in manufacturing with its index rising to 50.5 in January from 50.3 in December, easing fears that it might be slowing down. And last month, Germany registered its first increase in manufacturing activity since September, up to 48.8 from 46.9 in December, though France, Italy, Spain and Greece all declined. The ISM's nonmanufacturing index also increased, rising from a revised 53 to 56.8.

Car sales began the year with a bang, jumping 11.4% in January as the

annual selling rate hit 14.18 million, its highest point in more than two years. Annual sales have finished below 14 million for the last four years and a total of 12.8 million vehicles were sold in 2011. GM's sales were off 6.1% year-to-year because of the discounts it offered in January 2010. For companies that sold at least 100,000 vehicles in January, Chrysler led the way, up 44.3%, followed by Toyota (7.5%) and Ford (7.3%). Chrysler is officially back from the dead after its bankruptcy in 2009, having made \$183 million in 2011, its first full year in the black since 2005. By comparison, it lost \$652 million in 2010.

The Commerce Department said that factory orders were up 1.1% in December after a 2.2% increase in November. And Thomson Reuters reported that retail sales rose 4.2% in January from a year earlier, about double the forecast, though clearance sales were the key.

The S&P/Case-Shiller Home Price Index fell 1.3% in November from October and was 3.7% lower than in November 2010.

The Commerce Department said that construction spending rose 1.5% in December, the fifth straight monthly increase, and hit an annual rate of \$816.4 billion, its highest point in 20 months. For all of 2011, spending totaled \$787.4 billion, 2% lower than in 2010 and about half of what's considered to be indicative of a healthy economy.

Finally, Facebook filed for an IPO that could value the company as high as \$100 billion – it's looking to raise \$10 billion. For the moment, Google holds the record for the largest Internet IPO – it had a valuation of \$23 billion and raised \$1.9 billion.

A Look Ahead

In the wake of the Super Bowl win by the Giants, it will be relatively quiet this week, with only a handful of closely watched releases, including the latest on wholesale inventories, the trade balance and the monthly budget statement.



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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.

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 Union (EU) is an economic and political union of 27 member states which are located primarily in Europe.

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 gross domestic product (GDP) is the amount of goods and services produced in a year, in a country.

The Institute for Supply Management (ISM) 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 Manufacturing Index tracks the amount of manufacturing activity that occurred in the previous month.

Thomson Reuters is an information company combining industry expertise with innovative technology to deliver critical information to leading decision makers in the financial, legal, tax and accounting, healthcare, science and media markets.

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.

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