

WEEKLY MARKET COMMENTARY

Late last week, Greece's leaders finally proposed yet another austerity plan in

order to get the bailout money it needs to stay solvent. But all three major stock indexes fell for the week for the first time in 2012, if only just, as tensions and violence escalated in Greece and as analysts and investors alike wondered whether even the latest steps would save the nation from bankruptcy.

Overall, Greece agreed to reduce spending by €3 billion (\$4 billion) in 2012, cut the minimum wage for public sector workers by 22%, pare pension benefits and eliminate 150,000 of the 800,000 total government jobs by 2015. The reaction was swift and ominous – cabinet members resigned, a scheduled general strike turned ugly and European leaders publically expressed skepticism, bordering on scorn, about Greece's commitment to rebuilding.

Even so, there's a catch or two, as usual. First, the troika that controls the bailout payment – the European Central Bank (ECB), the International Monetary Fund (IMF) and the European Union (EU) – wanted even bigger cuts. Next, though the plan was approved by Parliament on Sunday – with riot police on hand to contain thousands of protesters – both sides will have to scramble to complete the paperwork before March 20 when Greece has its next debt payment. And finally, the Greeks still have to close the deal with their private bondholders over the voluntary reduction of the interest rate on the debt load.

In addition, there's the fact that almost all of the €130 billion (\$170 billion) bailout would be earmarked for debt service and not much-needed economic stimulus. And the economic picture is getting even grimmer, hard as that may be to believe. Last week, Greece's unemployment rate rose to 20.9%, its debt now amounts to 160% of GDP and economic growth is expected to fall another 5 to 6% in 2012. As Antonis Samaras, one of the coalition leaders said, "No nation can endure daily austerity without some light at the end of the tunnel," adding that too much austerity would "fuel a social explosion" - and he voted for the plan. Before doing so, he said, "I ask you to vote in favor of the new loan agreement today and to have the ability to negotiate and change the current policy, which has been forced on us" - not exactly what the troika wanted to hear.

In America, where the economic news has been unexpectedly upbeat for most of the year, politics began to take centerstage once more with the testy negotiations over the Social Security payroll tax extension and the first responses to the details of the president's budget for fiscal 2012, which will be released today.

With the Feb. 29 deadline looming, the two sides are miles apart over renewing the payroll tax cut, with the sticking point being how to pay for it. The Democrats, once again, are looking to tax Americans making over a million dollars, and the Republicans want to take the money from



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Key Market Data

week ending...	2/3/12	2/10/12	Change
Dow Jones Industrial Average Index	12,862.23	12,801.23	-0.47%
S&P 500 Index	1,344.90	1,342.64	-0.17%
NASDAQ Composite Index	2,905.66	2,903.88	-0.06%
10-Year Treasury Note Rate	1.943%	1.971%	+0.027 pct. pts.
NYMEX Crude Future (Barrel)	\$97.84	\$98.67	+0.85%
Euro/U.S. Dollar	\$1.3159	\$1.3199	+\$0.0039
MSCI EAFE Index	1,529.46	1,524.97	-1.60%

entitlement programs. Both sides seemingly have a lot to lose politically if they fail to renew the extension: the GOP because it will be blamed by voters for its intransigence and the Dems because of the bite a tax hike would take out of the recovering economy – and their chances for reelection.

The president's budget represents a larger-scale version of that same debate and was widely seen as a key part of his reelection campaign. Overall, it doesn't look to attack the deficit but rather to raise revenue by taxing wealthy Americans and spending money to create jobs, all while leaving entitlement programs largely untouched, strategies the GOP has repeatedly rejected. The budget plan will show a projected deficit of \$1.33 trillion for the year ending Sept. 30, or 8% of GDP, which would make it the fourth budget in a row with a deficit over \$1 trillion.

The government also announced an agreement with five banks to pay \$26 billion to settle charges of mortgage irregularities, but it will only help homeowners in distress whose loans are covered by those banks in particular. The contributions range from \$11.8 billion from the Bank of America to \$301 million from Ally. About \$20 billion will go to a million homeowners who will have their mortgage debts reduced or the interest rate on their loans lowered, while people whose homes were foreclosed between 2008 and 2011 will receive \$1,500 to \$2,000. The plan will not cover mortgages from Fannie Mae and Freddie Mac, about half of the nation's total, and it isn't expected to have much of an impact on the economy or the housing market as banks have three years to make the payments. Acknowledging this, President Obama said, "No action, no matter how meaningful, is going to by itself entirely heal the housing market. But this settlement is a start."

Last week it was the House, and this week Federal Reserve Chairman Benjamin Bernanke came before the Senate Budget Committee to defend his policies, which the GOP have protested because they see him as spending more time worrying about unemployment than housing, officially his lone mandate. Mr. Bernanke again stood his ground – the Fed's approach, he said, was "fully balanced and symmetrical" – and again encouraged deficit reduction, though when pressed, he didn't offer a plan: "That's what people elected you to do," he said.

The two parties did come together on one issue last week, passing the insider trading bill that has been on the table for six years now. The Senate had approved it two weeks ago and last week the House did so by a resounding vote of 417 to 2. There always seems to be a catch, however, and there are enough differences between the two versions that they'll have to be ironed out in committee before the bill goes to the president to be signed.

In other economic news, the employment story continued to get better as first time jobless claims fell 15,000 to 358,000 and the four-week average dipped to 366,250, its lowest point since April 2008. The Bureau of Labor Statistics said the number of job openings rose by 8.3% in December to 3.4 million and, excluding government agencies, openings at private employers climbed to their highest level since August 2008. In addition, the White House updated its forecast based on the recent economic upswing, and it now estimates that two million jobs will be created this year, assuming the payroll tax break and unemployment assistance are extended, with the result that unemployment could be as low as 8% by year end. The budget, based on numbers from mid-November, will project an average unemployment rate of 8.9% this year and 8.6% in 2013.

The Commerce Department said the trade gap was up slightly to \$48.8 billion, as imports rose 1.3% to \$227.56 billion, their highest level since

July 2008, before Lehman Brothers. For the year, the trade gap increased 11.6% to \$558 billion, its highest point since 2008. Exports rose 14.5% in 2011 to \$2.1 trillion, and imports were up 13.8% to \$2.7 trillion. And in 2011, the deficit with China was up 8.2% to \$295.5 billion, a new record.

China, meanwhile, announced its biggest drop in trade in January since 2008, with exports off 0.5% from a year earlier to \$149.9 billion and imports down 15% to \$122.7 billion. Still, compared to a year earlier, China's trade surplus tripled to \$27.3 billion.

The Fed said that consumer borrowing increased \$19.3 billion to \$2.5 trillion in December after rising \$20.4 billion in November, the two biggest monthly increases in a decade and 4.4% higher than the post-recession low in 2010.

Wholesale inventories were up 1% in December from November and sales improved 1.3%, the fastest clip since March.

After saying that China was thinking about helping Europe by investing in its bailout fund, Prime Minister Wen Jiabao added some qualifications that were tailored for the home audience, as some Chinese don't like the idea of China coming to the rescue of its long-time rivals. "Now that Europe is facing a debt crisis, we must consider our relations with Europe strategically and preserve our national interests," he said, adding, "helping to stabilize the European market is actually also helping ourselves." Xi Jinping, the man widely expected to be China's next president, will visit the United States this week.

The ECB and the Bank of England both left their benchmark rates unchanged, at 1% and 0.5% respectively, though the latter decided to extend its asset buying program to try and boost the sagging economy. Mario Draghi, the ECB's president, said he saw some "tentative signs of stabilization in economic activity at a low level," which was as close as it gets to good news in Europe right now.

Standard & Poor's reduced the credit rating of 34 Italian financial firms in the wake of having cut Italy's rating from A to BBB+ on Jan. 13. Worse still, the report stated, "We anticipate persistent weak profitability for Italian banks in the next few years."

Lastly, Emil Boc, the prime minister of Romania, became the latest leader to be a victim of the recession in Europe, resigning because of discontent over austerity plans that his government had to put in place in return for an emergency loan of \$27 billion from the IMF in 2009. Romania is usually seen as the second poorest member of the EU after Bulgaria. Boc joins a list that includes the leaders of Denmark, Finland, Greece, Ireland, Italy, Portugal, Slovakia and Spain. Nicolas Sarkozy, coming up for reelection this year, is hoping to avoid being next.

A Look Ahead

As Greece and its creditors work to keep the nation afloat, the Democrats and Republicans will continue to cross swords over the payroll tax extension, with the new budget as a divisive backdrop. Meanwhile, there will be a flurry of economic updates, including the latest on retail sales, the producer and consumer price indexes, business inventories and industrial production, housing starts and building permits, and the Conference Board's leading indicators. The Fed will release the minutes of its first meeting of 2012 held last month, though with its new policy of transparency there may be less to

read between the lines than usual.



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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.

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

The Federal National Mortgage Association, doing business as Fannie Mae, buys and holds mortgages, and issues and sells guaranteed mortgage-backed securities to facilitate housing ownership for low to middle-income Americans. The Company was chartered by the U.S. Congress but went public in 1970.

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 Bureau of Labor Statistics is the principal fact-finding agency for the Federal Government in the broad field of labor economics and statistics.

Standard & Poor's (S&P) is a U.S.-based financial services company. As one of the Big Three credit-rating agencies, the company issues credit ratings for the debt of public and private corporations. It is one of several credit rating agencies that have been designated a nationally recognized statistical rating organization by the U.S. Securities and Exchange Commission.

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

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 prices included in the PPI are from the first commercial transaction for many products and some services.

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 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.

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