Northwestern Mutual
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Weekly Market Commentary by Emmett Wright

December 19, 2011

	Key Market Data		
	Week ending…		
	12/9/11	12/16/11	Change
Dow Jones Industrial Average Index	12,184.26	11,866.39	-2.61%
S&P 500 Index	1,255.19	1,219.66	-2.83%
NASDAQ Composite Index	2,646.85	2,555.33	-3.46%
10-Year Treasury Note Rate	2.056%	1.853%	-0.203 pct. pts.
NYMEX Crude Future (Barrel)	$99.41	$93.53	-5.91%
Euro/U.S. Dollar	$1.3385	$1.3043	-$0.0342

And then came the second thoughts.
The week before last, members of the European Union – all but one, anyway – and investors seemed pleased that the plan worked out in Brussels was a major step forward toward saving the euro and addressing the sovereign debt crisis that just won't go away. Stock indexes both in Europe and here in the United States leapt off the news. But the end of this past week, not only had doubts set in, but member countries were also squabbling about the details of the plan and its viability, and there was sniping both within and toward Great Britain, the only one of the 27 members that hadn't come on board. Worse still, the European Central Bank made it clear it would not change course and buy more bonds. As a result, bond yields in Italy rose to euro-era record highs, with the 10-year issue passing the dreaded 7% mark. And the ratings agencies, disappointed about Brussels, appeared poised to downgrade the credit ratings of a number of eurozone members, including France. In short, Brussels, after initially-encouraging reviews, turned out to be a flop. As *The Economist* noted, "Once again Europe's leaders have failed to solve the euro crisis," ominously adding, "Sooner or later, the euro will be beyond saving."

Those second thoughts about the accord were myriad: How much money is needed to protect Italy from the speculators betting against it, and where will it come from if not the vaults of the ECB? Will the eurozone's largest banks survive, given their exposure to the region's struggling economies? What of Britain? Will the deal, mostly designed to impose and enforce greater financial discipline down the road, do anything to promote much-needed economic growth in the near term, especially as Europe seems ready to fall into a full-fledged recession? And will the steps taken, mostly procedural, even matter, especially as the deal at Brussels, requiring treaty revisions, isn't expected to be ratified until the end of next summer? That's a lot of ifs.

Meanwhile, as noted, Britain and France were blaming each other for the former not agreeing to the plan – Britain said the terms were too invasive and France accused it of being obstructionist. And even within Britain there was finger-pointing going on, with the Deputy Prime Minister Nick Clegg saying he was "bitterly disappointed" about what happened and that he thought Britain would be "isolated and marginalized." Clegg is a Liberal Democrat and not a member of Prime Minister David Cameron's Conservative Party.

But the gravest concerns for investors were the rumblings from the ratings agencies. Early in the week, both Moody's and Fitch warned that the steps taken in Brussels hadn't addressed the current crisis and echoed S&P, which had already indicated there could be further downgrades. Fitch said that the "gradualist approach" meant that "the crisis will continue at varying levels of intensity throughout 2012 and probably beyond." And Moody's sounded an even more ominous note, saying the longer it took to work out a solution, "the greater the likelihood of more severe scenarios, including those involving multiple defaults" and "exits from the euro area." Olli Rehn, the European commissioner for economic and monetary affairs, countered, "The results of this summit are better than first meets the eye," but the skeptics were legion. Though miffed, France's President Nicolas Sarkozy, up for reelection in 2013, said he was expecting a downgrade of France's AAA status but insisted the setback would not be "insurmountable."

In Italy, the new Prime Minister Mario Monti did manage to get his austerity plan through the lower house of parliament (the upper house is scheduled to vote on it this week), but along the way it was watered down by resistant politicians and the protests of unions. As a result, the initial enthusiasm for the ascension of "Super Mario" the technocrat is beginning to fade as politics-as-usual kick in to protect vested interests and resist the structural changes that need to be made to revive Italy's economy, such as paring the bureaucracy and taking on unions and pensions.

Because of the waning enthusiasm, European investors and leaders have again begun turning their attention to the ECB for help, just as Americans look to the Federal Reserve. But both Germany and the ECB's chief Mario Draghi remain against the ECB buying more bonds to keep Italy and Spain afloat, Draghi saying last week that such bond purchases were "neither eternal, nor infinite."

At week's end, Christine Lagarde, the head of the International Monetary Fund, visited Washington and succinctly summed up the situation: "It's a question of actually facing the issues, not being in denial, accepting the truth, accepting the reality, then dealing with it."

Not that matters in Washington were much better. With the Christmas recess looming, the two parties continued to bicker over extending the Social Security payroll tax cut that's scheduled to expire on Dec. 31, despite the fact that both sides appear to be for it – and they should be as it impacts 160 million Americans (and voters), and economists have warned that not extending the cut would curtail GDP growth in 2012. The two parties continue their brinksmanship despite record-low approval ratings from voters, mainly because both the Democrats and Republicans insist on including in the package proposals that the other side sees as ideological – for the Democrats, a surtax on millionaires, and for the GOP, approval of the XL Keystone pipeline. All you need to know about the yawning distance between the two sides is that Senate Majority Leader Harry Reid (D - Nev.) called the inclusion of Keystone a "pointless partisan exercise," while Speaker of the House John Boehner (R - Ohio) said the pipeline project was "shovel ready" and would create much-needed jobs. With the deadline looming, it looks like something will get done, but it may end up being only a short-term solution, a two-month extension, for instance. That means that the whole debate will start up again when the members of Congress come back to work in 2012 which, for those who've tried to forget, will be an election year in which partisanship is likely to get worse, not better.

That said, there was some truly positive news coming out of Washington from the Labor Department if not the Senate or

House, when the number of first-time unemployment claims fell by 16,000 to a three-and-a-half-year low of 366,000 (not long after the overall unemployment rate dropped to a two-year low of 8.6%).

Better still, forecasts for fourth-quarter GDP growth are now running as high as 3.9% because of better-than-expected numbers for consumer spending and exports, though a further collapse of European markets could obviously be a game-, and numbers-, changer.

Investors were less excited when the Federal Reserve had its last meeting of 2012 and made no indication that it was considering yet another round of quantitative easing, as some had hoped. The Fed was slightly more positive about the state of the economy than it had been at its previous meeting, saying, "The committee continues to expect a moderate pace of growth over coming quarters," but also noted there was still a "significant downside risk" because of unemployment, the weak housing market, a broad global slowdown and the perils of the euro. The Fed's benchmark rate remained, as expected, unchanged.

In other news, the Commerce Department said that retail sales were up only 0.2% in November, the smallest increase in five months, leading to doubts about the holiday spending season. However, business inventories rose at their fastest pace in five months, indicating that companies are anticipating stronger consumer demand.

The Labor Department said that U.S. import prices had their biggest jump since April in November, up 0.7% because of higher oil prices, but that was not seen as worrisome from an inflation standpoint as, excluding oil, prices fell 0.2%. And the consumer price index remained unchanged, indicating that inflation is indeed in hand; year to year, it was up 3.4%. The core index, excluding food and energy increased 0.2% in November and was up 2.2% from a year earlier. The producer price index was up 0.3% in November and 5.7% from November 2010, while its core index increased a modest 0.1% for the month and 2.9% year to year. The Labor Department also announced that wholesale prices rose 0.3% and food prices climbed 1%. Without food and energy, prices were up just 0.1%

The Fed reported that industrial production fell 0.2% in November after having improved 0.7% the month before, though the drop was mostly attributable to a 3.4% decline in motor vehicle production.

And finally, the United States officially lowered the flag in Baghdad, ending the nine-year war in Iraq.

A look ahead

This week we'll see if Congress can in fact get enough of the holiday spirit to wrap up the payroll tax extension before Christmas. We'll also see how the euro and the eurozone will fare in the face of rising anxiety – and bond yields – especially if the ratings agencies follow through with credit downgrades, as expected. In addition, there will be a long list of updates for the U.S. economy, including housing starts, building permits, and existing and new home sales; an update on third quarter GDP growth (which analysts believe will remain unchanged at 2%); the latest on personal consumption, income and spending; orders for capital and durable goods; and the Conference Board's list of leading indicators.

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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.

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 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 Economist is an English-language weekly news and international affairs publication owned by The Economist Newspaper Ltd. and edited in offices in the City of Westminster, London.

Moody's Investors Service , Fitch Group and Standard & Poor's (S&P) are considered “the big three” credit rating agencies, holding about 95% of market share. S&P and Moody's are U.S.-based, while Fitch is dual-headquartered in New York City and London, and is controlled by the France-based FIMALAC. All three have been designated nationally recognized statistical rating organization by the SEC.

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 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.