

WEEKLY MARKET COMMENTARY

With investors putting a positive spin on earnings reports from giants such as

GE, Microsoft, and McDonald's on Friday, the Dow muscled its way back over the 13,000 mark and the S&P 500 also inched into the black for the week. However, concerns that shares of Apple may have soared too high led to a selloff, and that stock's fall singlehandedly brought the NASDAQ down for the third week straight.

Overall, first-quarter earnings have been coming in well above expectations, with Thomson Reuters saying that 81% of the companies reporting have beat forecasts. Apple, which has lost about 10% or \$56.5 billion of its value since the stock closed at \$644 a share on April 9, will report first-quarter earnings on Tuesday.

But while the story in the United States was generally upbeat, Spain continued to be the flashpoint, and last week the yield on its 10-year rose above 6% and the cost of default protection hit another new high. Spain's stock index, the IBEX 35, has fallen 19% over the past month and is near where it was back in 2009. The news was not much better from Italy which said that, with its recession being aggravated by austerity measures, it won't be able to balance its budget next year, as promised, and now expects to post a budget deficit of 0.5% of GDP. Italy forecasts a GDP contraction of 1.2% in 2012, but the IMF says 1.9% and doesn't expect Italy to balance its budget until 2017. Meanwhile, Moody's announced that it will put off until May what's expected to be yet another dose of bad news; a large number of ratings downgrades for 144 European banks in 16 countries.

Even so, prior to its meeting in Washington, D.C. over the past weekend, the International Monetary Fund (IMF) announced a slightly more upbeat forecast for global growth this year, though with the usual caveat: the threat of Europe holding the rest of the world back.

The IMF said the global economy will gain 3.5% this year and 4.1% in 2013, both up from its previous estimates, with GDP in the U.S. forecast to improve 2.1%. Later in the week, James Bullard, the president of the Federal Reserve Bank of St. Louis, said he believed that the pace of U.S. economic growth will quicken from 2.5% to 2.7% during the first quarter (that figure will be released this Friday), and 3% for all of 2012.

As the updated estimates were released, Christine Lagarde, the head of the IMF, said there was a "light recovery blowing in a spring wind" with "dark clouds on the horizon," calling Europe the "epicenter" of the potential problems. Not incidentally, some observers see the failure of European leaders to act more decisively leading to a diminution of their clout within the IMF, opening the door for developing powers such as China and Brazil.

The IMF also called for European countries to ease the pain by putting a longer time frame in place for some austerity plans. However, the target of the message, Germany, is unlikely to give any ground soon as Chancellor



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Key Market Data

week ending...	4/13/12	4/20/12	Change
Dow Jones Industrial Average Index	12,849.59	13,029.26	+1.40%
S&P 500 Index	1,370.26	1,378.53	+0.60%
NASDAQ Composite Index	3,011.33	3,000.45	-0.36%
10-Year Treasury Note Rate	1.996%	1.970%	-0.026 pct. pts.
NYMEX Crude Future (Barrel)	\$102.83	\$103.45	+0.21%
Euro/U.S. Dollar	\$1.3078	\$1.3218	+\$0.0140
MSCI EAFE Index	1,488.02	1,511.15	+1.55%

Angela Merkel's party has two state elections on the horizon and German voters feel they have already done enough, if not too much, to bail out their profligate neighbors.

At the meeting, IMF members agreed to kick in \$430 billion that could be loaned to countries in trouble, read euro-zone members, almost doubling the size of the "firewall" to \$700 billion. "We made a call to action and our members have delivered," Lagarde said.

The World Bank also met last week and, as expected, despite some rumblings of discontent, Jim Yong Kim, the American nominee, was elected as its next president. Some of the bank's members had pushed for a non-American candidate, which would have been a first, but in the end developing countries such as China and India voted for Mr. Kim, the president of Dartmouth College and a healthcare expert. In a nod to the push for a non-American candidate, Mr. Kim said he would "seek a new alignment of the World Bank Group with a rapidly changing world." Mr. Kim will take office in July.

On Sunday, France's President Nicolas Sarkozy and his rival François Hollande from the Socialist Party were the top vote getters in the first round in the country's presidential elections – the two will face off for the presidency on May 6. Both men have been pushing for the European Central Bank to take a more active role in bolstering growth, with Mr. Hollande recently suggesting that low-interest loans be made directly to countries in distress rather than to banks. However, any such steps by the ECB, including the purchase of Spain's bonds, are not expected anytime soon, and its President Mario Draghi is seen as being even less likely to act if he thought he'd be seen as caving to political pressure. Mr. Sarkozy, like Mr. Obama, is trying to avoid being a one-term president. Should Mr. Hollande win in May, he's expected to introduce his own version of the "Buffett Rule" to tax the rich. His victory would also impact the working relationship that Mr. Sarkozy has developed with German's Angela Merkel, leading to the nickname "Merkozy."

Treasury Secretary Timothy Geithner sounded a similar note about the ECB when he spoke to the IMF on Saturday, saying, "The success of the next phase of the crisis response will hinge on Europe's willingness and ability, together with the European Central Bank, to apply its tools and processes creatively, flexibly and aggressively to support countries as they implement reforms and stay ahead of markets."

Having returned from a short recess, Democrats and Republicans continued to square off and set the stage for this November's showdown. On Monday, the day that taxes were due, Republicans in the Senate blocked debate on the "Buffett Rule," the president's proposal to raise the tax rate on millionaires to 30% so that it could not come to a vote. The Senate Minority Leader, Mitch McConnell (R, Kentucky), said it was a "political gimmick" that "even Democrats admit won't solve our problems," adding, "It's shown the president is more interested in misleading people than he is in leading." The Democrats cited a recent Gallup poll that showed 60% of Americans favored the rule which Senator Charles Schumer (R, New York), said was "proof positive" that "for the first time in decades, maybe generations, they're defensive on their signature issue" of taxes. A CNN poll released after the vote showed 72% of respondents were for the rule, including 53% of Republicans. In a related note, the namesake of the rule, Warren Buffett, announced last week that he's being treated for non-life-threatening prostate cancer.

Responding to the blocked vote, the White House said it would block any new spending bills until the House backed off on the spending cuts it had recently approved. The House resolution approved in March cut non-military spending for the 2013 fiscal year by \$28 billion below the levels agreed to last year.

The Senate's Budget Committee is taking up the budget for 2013, using the bipartisan plan proposed in 2010 by the president's Debt Reduction Committee as a starting point. The committee's chairman, Kent Conrad (D, North Dakota), said he wouldn't hold a vote until both sides agree on a plan, adding, "It's unlikely we will reach agreement until after the elections. That's just reality." The Bowles-Simpson plan would cut the deficit by \$5.4 trillion over a decade.

Later in the week, the House passed a \$46 billion tax cut to benefit businesses and rejected the Buffett Rule. It was a one-year, 20% cut for businesses with fewer than 500 employees, but it's not expected to survive the Senate and the president has said he would veto it in any case. The tax cut passed by a vote of 235 to 173 while the Buffet Rule fell 234 to 179.

Though most analysts are now saying the price of oil has leveled off, President Obama announced he was going to increase the oversight of the oil market to battle manipulation by speculators as opposed to drilling. "There are politicians who say if we just drill more, gas prices will come down," he said in a speech in the Rose Garden. "What they don't say is that we have been drilling more," adding that no amount of drilling would completely address the problem that we use far more oil, 20% of the world's reserves, than we produce, about 2%.

The latest New York Times/CBS News poll showed that Americans are generally more confident about the state of the economy, but general concern about their own finances is making them receptive to Mitt Romney's ideas. Two-thirds of the respondents were concerned about paying their mortgages and about 20% were "underwater." Another 40% said they were rethinking the kind of college they could afford for their kids and more than 33% talked about the pain higher gas prices had caused. In a straw poll, each of the two candidates came in with 46% of the vote.

In other economic news, the Commerce Department said that retail sales were well above expectations of 0.3% in March, coming in at 0.8%. Better still, sales were still up 0.7% when gasoline and automobile sales were removed. The Commerce Department also said that business inventories claimed 0.6% in March to a new record of \$1.58 trillion while business sales rose 0.7% to \$1.24 trillion.

In quite a turnaround given what had been a long run of good news, anxiety about jobs continues to grow, and last week the Labor Department said that while first-time jobless claims were slightly down last week to 386,000 from 388,000, the four-week moving average was up to 374,750, its highest point in three months.

Industrial production output fell 0.2% in March, the Fed reported, the first drop in four months after an increase of 0.8% in February. Capacity utilization was down to 78.6% from 78.7%; by way of comparison, the 1972-2011 average was just over 80%. The Conference Board's index of leading indicators was up 0.3% in March after a 0.7% rise in February.

There continues to be little if any good news about the housing sector, and last week the Commerce Department said that housing starts were off 5.8%

in March to a seasonally adjusted annual rate of 654,000. The National Association of Realtors reported that sales of previously owned homes fell 2.6% in March to a seasonally adjusted annual rate of 4.48 million compared to 4.6 million in February, but they were up 5.2% from a year earlier.

In a sign of how shareholders are getting fed up with CEOs' pay, Citigroup's shareholders shot down the \$15 million salary of CEO Vikram Pandit as well as that of five other top executives at the company's annual meeting in Dallas. The move was nonbinding but it was the first time such a step has been taken at a bank of that size since the Dodd-Frank reforms introduced the "say no on pay" provision.

The Reserve Bank of India cut its rate for the first time in three years to 8% from 8.5%. The bank had raised the rate 13 times from March 2010 to October 2011 to combat inflation, but it's now concerned with slower growth; India's economy grew 6.9% in the first quarter, the slowest pace in three years.

Finally, though Mr. Romney has pledged to brand China a currency manipulator the day he takes office, last week China's central bank moved to expand the yuan's daily trading range against the dollar, the first such move since 2007. The central bank still sets the daily reference rate, but it was a move we have long pushed for and The Economist noted that the currency "now looks close to its fair value."

A Look Ahead

In addition to more earnings reports, headlined, as noted, by Apple on Tuesday, this week will feature two key releases that will be closely watched by investors: the rate decision by the Federal Reserve on Wednesday after its two-day meeting and first-quarter GDP on Friday. The Fed is not expected to change its benchmark rate anytime soon, but Fed watchers will scrutinize the press release as well as what Fed Chairman Benjamin Bernanke has to say. And a higher-than-expected GDP reading will no doubt give a much-needed boost to investor confidence. In addition, there will be updates on new and pending home sales, the Standard & Poor's/Case-Shiller home price index, durable and capital goods orders, and personal consumption.



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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 indexes 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 IBEX-35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange. It is a market capitalization weighted index comprising the 35 most liquid Spanish stocks traded in the Madrid Stock Exchange General Index, which are reviewed twice annually.

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.

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.

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.

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