

WEEKLY MARKET COMMENTARY

All three of the major U.S. stock indexes went south last week but, given the run of

bad news that began the preceding Friday with a disappointing jobs report, the retreat seems modest and measured. The governments in France and Greece were both overturned by disgruntled voters, and there will be a do-over in Greece since none of the leading vote-getters could gather enough support to form a working government. Then, JPMorgan Chase announced that it had lost at least \$2 billion because of some of the same trading practices that were supposed to have been curbed after the Lehman Brothers collapse, and China's first-quarter GDP growth fell to its lowest mark since 2009. Even so, in the midst of all of this, consumer confidence actually hit a four-year high, in large part, analysts believe, because of lower prices at the pump.

Given the turmoil of the recent elections, it was a fairly quiet week in France, perhaps because Françoise Hollande had been expected to win, and also because many other European leaders – excepting those in Berlin, of course – agree with his concerns that austerity is choking growth. Italy's Prime Minister Mario Monti, for example, said the French vote was a “call for a reflection on European policies,” adding that the objective is “sustainable growth that creates employment and is oriented toward social equality.” Some eurozone leaders want the Germans to loosen up and help, while others are pushing the European Central Bank to buy more bonds. Mr. Hollande has refloat the idea of euro bonds, another solution the Germans have repeatedly rejected. And when Chancellor Angela Merkel weighed in, she made her stance about the new era of austerity clear: “The fiscal pact is not negotiable.” Monti rebutted, “You need rigor, but you also need something that gives people hope.”

Nonetheless, Hollande said his victory was “a fresh start” and added that “austerity need not be Europe's fate.” Hollande has said he would raise taxes on big corporations and on millionaires, but both Mr. Hollande and the outgoing president Nicolas Sarkozy promised during the election to balance the budget in the next five years. Mr. Hollande is expected to be at the Group of 8 meeting in Washington, D.C. this Friday and Saturday.

The post-election story in Greece was far less settled. The election was widely seen as a referendum on austerity and the terms of the March bailout, and the voters made it clear that they were angry as the two main parties that had negotiated those terms, the New Democrats and the Socialists, were clobbered. Though some fringe parties gained seats in Parliament, the new power on the scene looks to be the Coalition of the Left, a.k.a. Syriza, which won the second largest number of seats. Its charismatic leader Alexis Tsipras, who has taken center stage, said of the elections, “The popular verdict clearly renders the bailout deal null,” and decried “the financial barbarism we have experienced in recent years.”

However, a week after the election, a government had not been formed. In Greece, the party that wins the most seats has three days to form a working



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Key Market Data

week ending...	5/4/12	5/11/12	Change
Dow Jones Industrial Average Index	13,038.27	12,820.60	-1.67%
S&P 500 Index	1,369.10	1,353.39	-1.15%
NASDAQ Composite Index	2,956.34	2,933.82	+0.76%
10-Year Treasury Note Rate	1.880%	1.841%	-0.039 pct. pts.
NYMEX Crude Future (Barrel)	\$98.49	\$96.13	-2.40%
Euro/U.S. Dollar	\$1.3084	\$1.2917	-\$0.0167
MSCI EAFE Index	1,483.87	1,444.52	-2.65%

coalition, after which the task falls to the runner-up and then, as was the case this time, the third-place finisher. The New Democracy Party was first up because it had the most seats, though far fewer than it had before the election. Strike one. The job then passed to Syriza, but Mr. Tsipras admitted his “dream of a government of the left cannot be realized.” Among other steps, his party wanted to pull out of the \$170 billion bailout agreement reached in March and end the current austerity measures. Strike two. The Socialists were up next, and its leader Evangelos Venizelos warned that an exit from the euro would lead to “mass poverty.” But Tsipras rejected an invitation from the Socialists to form a government, saying the rejection “does not come from Syriza; it comes from the Greek people.” Strike three.

There will now be another election, most likely on June 17, but the issue is complicated, to put it mildly, by the fact that Greece is required to cut another \$15 billion from its budget by June, which won't be easy if there's no working government. With the European lenders already on alert, Greece did not get all of its bailout payment this week; it was expecting to get €4.2 billion and the lenders held back €1 billion that will only be handed over in June if Greece meets the terms of the bailout. (Over this past weekend, Karolos Papoulias, the current president of Greece, said that he would get the three party leaders together to try and broker a deal, but the odds were seen as very long indeed.)

The drama was hardly relieved later in the week when the European Commission said that Spain, the nation at the top of everyone's watch list right now because of the size of its economy, was going to miss its deficit reduction targets for 2012 and 2013, putting the budget deficit at 6.4% of GDP this year and 6.3% in 2013. According to the terms of the new fiscal compact that Chancellor Merkel is insisting upon, Spain's deficit as a percentage of GDP was supposed to fall to 5.3% this year and drop down to 3% in 2013. The EC also said that Spain would be the only European country that would still be in recession next year. For the entire European Union, growth was forecast to be flat this year but up 1.3% next year. However, the 17-nation eurozone will contract 0.3% in 2012 and gain only 1% in 2013. As for other countries on the radar, France's economy is forecast to grow just 0.5% this year and 1.3% in 2013, while Greece will suffer through its fifth year in a row of a recession this year, off 4.7%, and growth will be flat in 2013.

In the U.S., JPMorgan Chase reported a \$2 billion trading loss that led some to wonder if the bank oversight system had made any progress since Lehman Brothers crashed because the loss involved derivatives, the mysterious and complicated financial instruments that are seen by many as a key cause of the recession. Senator Carl Levin (D - Mich.) said, “Today's announcement is a stark reminder of the need for regulators to establish tough, effective standards.” The proposed Volcker Rule, which Mr. Levin helped write and which is expected to be released in the next few months, would stop banks from speculating with their own money, and there were reports that JPMorgan Chase had been lobbying the government for a loophole about precisely this form of trading. Jamie Dimon, the bank's CEO, said the loss was the result of “errors, sloppiness and bad judgment.” Mr. Damon, who has been a strong opponent of some of the proposed Volcker rules which he has said would be too expensive to implement and oversee, admitted that the loss “plays right into the hands of a whole bunch of pundits out there.” Sheila Bair, the former head of the FDIC, said, “This underscores the fallacy of thinking the best-managed banks are somehow infallible.” In any case, investors reacted, and shares of JPMorgan Chase dropped 9.3% on Friday, taking with it \$14.4 billion in market value. At the end of the day, Fitch cut the bank's credit rating to A+ from AA-.

Back in action in Washington, the House approved \$310 billion in cuts from the deficit over the next decade, a move that's not likely to survive the Senate. The House moved much of the money from programs for the poor, some of it to cover the Pentagon which stands to see its budget slashed next year as a result of the automatic cuts that will kick in because the House and Senate could not come up with a deficit-cutting compromise last year. The vote was 218-199, with 16 Republicans voting against the cuts.

Given its voracious appetite for commodities, China is seen as the most important engine of world growth, and this past week there was an indication that that engine is slowing, if still a long way from stalling. China's economy grew 8.1% in the first quarter, its slowest rate since the spring of 2009, and industrial output fell from 11.6% in March to 9.3% in April, the lowest level since May 2009. China also announced that import growth rose only 0.3% in April from a year earlier, whereas the expectation had been 11%. Exports increased 4.9%, about half of what was forecast.

In other economic news, as noted, The Thomson Reuters/University of Michigan index of consumer sentiment rose from 76.4 to 77.8, its highest level since January 2008.

Consumer debt, driven by credit card spending and money borrowed for school, jumped in March by 10.2% or \$21.4 billion to \$2.54 trillion, the Federal Reserve reported, the seventh straight increase and, more significantly, the largest jump since November 2001. The record high, set back in July 2008, was \$2.58 trillion. Economists typically see increased borrowing, and a willingness to take on more debt, as a sign of consumer confidence. At a banking conference in Chicago, the Fed's Chairman Benjamin Bernanke touched on this when he said that borrowers were finding it easier to get money because banks were in better shape: "Credit conditions in the United States have improved significantly in a number of areas."

The trade gap increased 14.1% to \$51.8 billion in March from \$45.4 billion in February, the biggest surge in almost a year even as exports were up 2.9% because of imports which rose 5.2%, the biggest jump since January.

The Commerce Department reported that wholesale inventories climbed just 0.3% in March which means the first quarter GDP figure of 2.2% will most likely be revised downward.

A week after the Labor Department said that only 115,000 jobs had been create in April, anxiety lessened somewhat after first-time jobless claims fell 1,000 last week to 367,000 and the four-week moving average dropped 5,250 to 379,000.

Producer prices were down 0.2% in April, mainly because of much lower prices for gas. Core prices, excluding food and energy, rose 0.2%.

Lastly, the Bank of England kept its benchmark interest rate unchanged at 0.5%.

A Look Ahead

With Greece in turmoil and Mr. Hollande on his way to Washington, there will be a number of updates and releases for investors to mull over this week, including the latest on the consumer price index, retail sales, business inventories, housing starts and building permits, and industrial production and capacity utilization. In addition, the Fed will release the minutes of its most recent meeting on April 24 and 25, and the Conference Board will

publish its leading indicators of future economic activity.



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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 Group of Eight (G8, and formerly the G6 or Group of Six) is a forum, created by France in 1975 for the governments of six major economies: France, Germany, Italy, Japan, the United Kingdom and the United States. In 1976, Canada joined the group (thus creating the G7). In 1997, the group added Russia, thus becoming the G8. In addition, the European Union is represented within the G8, but cannot host or chair.

The European Commission is one of the main institutions of the European Union. It represents and upholds the interests of the EU as a whole, drafts proposals for new European laws, and manages the day-to-day business of implementing EU policies and spending EU funds.

The University of Michigan Consumer Sentiment Index is a consumer confidence index published monthly by the University of Michigan and Thomson Reuters. At least 500 telephone interviews are conducted each month of a United States sample. 50 core questions are asked.