

WEEKLY MARKET COMMENTARY

Whether you were in the United States, Greece, Italy or Spain, it was a bad week to

be in the banking business. And the long-awaited and much ballyhooed Facebook IPO turned out to be something of an anticlimax. As a result, stock markets around the world were pummeled, with the Dow, S&P 500 and NASDAQ all suffering through their worst week of 2012. And, as a sign of just how raw nerves are right now, the yield on U.S. Treasuries dipped anew as investors ran for cover, with the yield on the 10-year dropping to 1.702%, a record low.

Greece, once again, was at the eye of the storm. With the leading vote-getters in the May election unable to form a working government, a new round of elections has now been scheduled for June 17 and the frontrunner is the Coalition of the Left (Syriza), which came in second in the last election, led by Alexis Tsipras. Mr. Tsipras, all but unknown outside of Greece a month ago, has become the face of Greek politics and has proved very skillful in his standoff with his creditors and, above all, Germany, essentially daring his fellow eurozone members to take punitive action against the country for not meeting what he sees as the punishing terms Greece agreed to when it was bailed out. He would not, as he put it when referring to the Greek leaders who had accepted those terms, “be complicit in their crimes,” and he told *The New York Times*, “It’s true. I like to play poker.” Still, should Greece renege on its austerity measures, it will soon have a tough time finding the money it needs to pay pensions and salaries. As for leaving the eurozone, Yannis Stourouaris, a leading Greek economist, said, “Leaving the euro is like a huge earthquake or a nuclear bomb. There will be no life.” Greece owes a lot of money to European banks and organizations such as the International Monetary Fund and the European Central Bank, \$500 billion by some estimates.

Later in the week, Germany’s Chancellor Angela Merkel tried to calm the waters by saying that Greece would stay in the eurozone and that she was open to stimulus programs to get its economy on track. “I have the will, the determination to keep Greece in the eurozone,” she said.

Polls show that most Greeks, in fact, do want to stay in the eurozone, but they also show that Syriza may well win in June, which makes Mr. Tsipras a man the Germans can’t ignore. Even so, the Greeks aren’t showing much faith in their own economy – it was reported that €1.2 billion (\$1.5 billion) was withdrawn from Greek banks on Monday and Tuesday of last week, 0.75% of total deposits. And, all told, an average of €4 billion (\$5.1 billion) has left Greek banks every month since 2009, when the debt crisis began. Later in the week, the European Central Bank further jangled nerves when it announced that it had stopped providing liquidity to some Greek banks that had not yet recapitalized, and Fitch chipped in by lowering its rating on Greek debt from B- to CCC.

The news for banks elsewhere, as noted, was not much better. In the United States, JPMorgan Chase said its loss of \$2 billion may eventually be twice



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Key Market Data

week ending...	5/11/12	5/18/12	Change
Dow Jones Industrial Average Index	12,820.60	12,369.38	-3.52%
S&P 500 Index	1,353.39	1,295.22	-4.30%
NASDAQ Composite Index	2,933.82	2,778.79	-5.28%
10-Year Treasury Note Rate	1.841%	1.702%	-0.139 pct. pts.
NYMEX Crude Future (Barrel)	\$96.13	\$91.48	-4.84%
Euro/U.S. Dollar	\$1.2917	\$1.2780	-\$0.0137
MSCI EAFE Index	1,444.52	1,356.90	-6.07%

that and the heads of those responsible will roll. Jamie Dimon, the bank's CEO, has been summoned to Washington in June to explain what happened. There were also reports that red flags raised by employees about the trades in question were ignored by upper management. Wall Street firms, concerned that Washington will tighten up the Volcker Rules, expected to be enacted in July, are looking to limit the damage. The main goal of the rules is to curb the ability of banks to trade with their own money and then get bailed out by taxpayers, but last week at least one lawmaker said that even more stringent rules would not have stopped what JPMorgan Chase did.

European Union finance ministers met in Brussels and, with the JPMorgan Chase story as a backdrop, voted to require banks to hold more capital. And in Spain, where tens of thousands of Spaniards marched in 80 cities to protest austerity measures, the government said that it would provide about €30 billion (\$39 billion) for its banks to offset bad loans, but Moody's warned that Spain's banks were still vulnerable. The Spanish government also had to contend with a report that there was a run on one of its largest banks, Bankia. And Moody's downgraded the credit ratings of 26 Italian banks, the first step in what is expected to be a wave of downgrades for European banks – in February Moody's put 114 financial institutions in 16 European countries on alert. Further, Fitch said that 29 of the world's largest banks, including JPMorgan Chase, must add \$566 billion in capital to guard against losses, an increase of 23%, as soon as possible, though by 2019 at the latest.

Tensions in Europe peaked on Friday when the Greeks reported that during a phone call with Ms. Merkel she had suggested that the Greeks hold a referendum on staying in the eurozone when the next election is held on June 17, which Greeks saw as pushy – Mr. Tsipras denounced her for treating his country as a “protectorate” – and which the chancellor denied having said.

Then over the weekend, the Group of Eight leaders were hosted by President Obama at Camp David in Maryland and, by all accounts, they teamed up to try and convince Chancellor Merkel that she needed to adopt a pro-growth package for Europe while pushing to keep Greece in the eurozone. In a joint statement, the G8 leaders agreed that deficits had to be addressed but also emphasized that austerity programs take into account the very different situations in different countries, saying, “the right measures are not the same for each of us” and adding that “all necessary steps” need to be taken to promote growth. After the meeting, President Obama called for “a responsible approach to fiscal consolidation with a strong growth agenda,” and Chancellor Merkel said that “great progress” had been made at the meeting.

At the beginning of the week, Ms. Merkel had met in Germany with François Hollande, France's new president. (In an ominous sign, his plane was hit by a bolt of lightning and had to head back to France and start all over.) Ms. Merkel said the first meeting was “a good omen for cooperation,” and Mr. Hollande added, “We want to work together with all the other countries for the good of the euro.” After the meeting, he told reporters, “Everything that can contribute to growth must be put on the table by everyone.”

Ms. Merkel also had to contend with a political setback when her Christian Democrat party was trounced in elections in North Rhine-Westphalia, Germany's largest state.

In the United States, Speaker of the House John Boehner (R - Ohio) continued to push what is now being called the Boehner Rule, pledging that

the House will not raise the debt ceiling again without much larger spending cuts. Mr. Boehner described reaching the debt limit as “an action-forcing event to a town that has become infamous for inaction.” The debt ceiling is not expected to be raised again until early 2014, after the November election, but the president said he had no intention of signing off on any spending cuts unless taxes on the rich were raised. With the memory of what happened last time the two parties squared off over the debt ceiling still fresh – anybody remember the debt downgrade? – the two parties are both staking their claims prior to the elections, the GOP that Americans have had enough of profligate government spending, the Democrats that the so-called “one percent” need to pay more taxes. Some political analysts saw Mr. Boehner’s move as risky because independents and moderates, key voters in the upcoming election, were more likely to blame the GOP than the Dems for last year’s debt drama. However, raising the ante, Mr. Boehner said the House would vote before the November elections to extend the Bush tax cuts, set to expire at the end of this year. Treasury Secretary Timothy Geithner also weighed in, asking Congress to raise the debt level next time “without the drama and the pain and damage that it caused the country last July.” Good luck with that.

The minutes of the Federal Reserve’s last meeting showed no reason to suspect that it will change course anytime soon, with members saying they would continue to try and lower borrowing costs for businesses and consumers. However, only four of the 17 committee members said they thought the Fed would leave its benchmark rate unchanged through 2014, down from six in January. There was also an awareness of problems in Europe and Congress about tax increases and spending cuts, the minutes saying that “uncertainty about fiscal policy could lead to a deferral of hiring and investment.” Finally, there was a hint that new stimulus policies could be employed if needed: “Several members indicated that additional monetary policy could be necessary if the economic recovery lost momentum or the downside risks to the forecast became great enough.”

Shares of Facebook were put up for sale on Friday and the company raised \$18.4 billion while gaining a market valuation of about \$105 billion. Shares opened at \$42.05 and closed at \$38.23, and late in the day the company’s own bankers had to step in and buy shares to keep them from falling below the initial opening price of \$38 (though some of them attributed the disappointing start to some snafus on the NASDAQ).

In other economic news, industrial production in eurozone countries in March fell 0.3% from February and 2.2% from a year earlier, both worse than forecast. However, the eurozone did not, despite expectations, slip into a new recession because it avoided two consecutive quarters of negative GDP growth; growth was flat after having been off 0.3% in the fourth quarter of 2011. Within the numbers, as might be expected, there was wide divergence, with Germany up 0.5%, France flat, Spain down 0.3% and Italy off 0.8%.

The Bank of England pared its forecast for growth in the U.K. from 1.2% earlier this year to 0.8% and said that inflation, currently at 3.5%, will stay above the bank’s target of 2% until mid-2013. In contrast, Japan’s economy gained 1% in the first quarter from the fourth, an annualized rate of 4.1%, largely because of government spending to rebuild after last year’s earthquake and tsunami.

The Labor Department reported that consumer prices were flat in April, mainly because the price of gas has declined, down 2.6%. Excluding food and gas, core prices were up 0.2%. Over the previous 12 months, prices

were up 2.3%, the slowest pace in a year.

The Commerce Department said that retail sales improved 0.1% in April. It also announced that new home construction rose 2.6% in April as builders broke ground on 717,000 homes.

The Mortgage Bankers Association said that at the end of March 11.8% of homeowners were behind on their payments, still high but down 12.8% from a year earlier and 14.7% lower than two years ago. But the foreclosure rate remained stubbornly high: 4.4% of mortgages were in some stage of foreclosure at the end of the first quarter compared to 4.5% a year earlier.

The Fed said that industrial production bounced back from March, up 1.1% in April, and is now only 6.1% off its peak before the recession began.

Finally, the Conference Board's index of U.S. leading indicators fell 0.1% in April after a 0.3% gain in March.

A Look Ahead

There will be a few new economic releases this week, notably new and existing home sales as well as durable and capital goods orders, but the focus will remain on the game of chicken being played between the Greeks and the Germans and the toll it will take on stock markets – and banks – around the world. Investors will also be keeping an eye out to see if Facebook takes off this week or stays within range of its opening day price.



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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 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 Central Bank (ECB) is the institution of the European Union (EU) which administers the monetary policy of the 17 EU eurozone member states.

Fitch Ratings issue credit ratings for the debt of public and private corporations. Known as one the "Big Three," it has been designated a nationally recognized statistical rating organization by the U.S. Securities and Exchange Commission.

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

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 Mortgage Bankers Association (MBA) is a United States national association representing all facets of the real estate finance industry. Headquartered in Washington, DC, MBA represents over 3,000 member companies nationwide.

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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