

WEEKLY MARKET COMMENTARY

Just when emboldened investors had finally started to move out of Treasuries for stocks,

the Dow had its worst week of 2012. It's all relative of course; the Dow only lost 1.1% and is still comfortably above 13,000, while the NASDAQ was up for the week. But the Dow's pause shows that there's still concern about the state of the recovery, especially abroad: about the price of a gallon of gas; about the rising level of partisan debate in Congress, which spiked anew last week when the House released its latest budget proposal; and perhaps about the looming election now that Mitt Romney seems a step closer to getting the nomination having handily won the Illinois primary.

As noted, the House Budget Committee unveiled the GOP's latest budget plan which its own author, Representative Paul Ryan (R - Wis.), admitted has no chance of passing: "We don't expect to make law this year, but we expect to give the country an alternative choice for the future." The plan, designed to dramatically reduce the deficit over the next decade, would include an overhaul of the tax system and end up with only two effective tax rates of 25% and 10%. It would also, among other changes, remake the Medicare program, a tricky proposition with the election looming – the AARP has already decried the plan, as have most Democrats, while Republicans are either on board or concerned that it doesn't go far enough. Mr. Romney chimed in, saying it was "a bold step toward putting our nation back on the track of fiscal sanity." Even so, both sides have admitted that it is largely about election-year politics and shaping the debate as November looms, while *The Economist* succinctly summed up the plan as, "an unworkable counter offer to the president's doomed budget."

On another budget note, the nonpartisan Joint Committee on Taxation estimated that the "Buffet Rule," proposed by President Obama to tax millionaires, would generate \$47 billion over 10 years, which would not make up the amount of money lost by abolishing the alternative minimum tax for middle-income taxpayers. And the Congressional Budget Office said that the president's budget plan would produce a \$977 billion deficit next year, about \$76 billion more than he had estimated.

Furthermore, a new congressional report prepared by the nonpartisan Congressional Research Service will give both sides fodder as the budget debate roils on. It showed that tax breaks add up to more than \$1 trillion each year, about the size of the annual budget deficit these days. The number one tax break is the exclusion of employer health insurance, which accounts for \$164.2 billion or 13.2% of the total, followed by the exclusion of employer pensions, worth \$162.7 billion or 13.1%.

Five years after being first proposed, the insider trading bill was also passed by the Senate (it had already made it through the House), a bill that had strong bipartisan support, especially in an election year. But, in what was seen as a partisan shot, the House eliminated a Medicare cost control panel that had been created by the president's healthcare bill. The constitutionality of that bill, specifically the fact that in 2014 every American will be required



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Key Market Data

week ending...	3/16/12	3/23/12	Change
Dow Jones Industrial Average Index	13,232.62	13,080.73	-1.15%
S&P 500 Index	1,404.17	1,397.11	-0.50%
NASDAQ Composite Index	3,055.26	3,067.92	+0.41%
10-Year Treasury Note Rate	2.301%	2.237%	-0.064 pct. pts.
NYMEX Crude Future (Barrel)	\$107.06	\$106.87	-0.66%
Euro/U.S. Dollar	\$1.3175	\$1.3270	+\$0.0095
MSCI EAFE Index	1,581.00	1,556.76	-1.53%

to have health insurance (or pay a fine), which is being challenged by 26 states, is scheduled to reach the Supreme Court this week.

The Jumpstart Our Business Startups (JOBS) Act was passed by the Senate 73 to 26 two weeks after getting through the House. It creates a new category of businesses designated as “emerging growth” that can hold IPOs without being subject to certain financial disclosure rules while also creating a new form of financing for small start-ups. However, enough tweaks were made in the Senate that the bill will have to go back to the House for approval before it gets to the president’s desk.

Appearing before the House on Wednesday, Treasury Secretary Timothy Geithner and Chairman of the Federal Reserve Benjamin Bernanke agreed that concerns about contagion in Europe, while still there, are dissipating. Mr. Geithner said, “The European economies at the center of the crisis have made very significant progress,” and Mr. Bernanke seconded, “In the past few months, financial stresses in Europe have lessened, which has contributed to an improved tone of financial markets around the world, including in the United States.” Evidence of that “improved tone” in Europe includes the rising yield on German bonds, long a safe haven, while bond yields in France and Italy have fallen. There is also the recent fiscal compact designed to enforce greater economic discipline upon European Union (EU) members, the second bailout of Greece and the cheap money that the European Central Bank (ECB) has made available.

Issues remain, of course. First, there’s the fact that Europeans aren’t spending much which will start to take a toll on American exports. And then there’s the latest country to move to the top of the watch list, Spain.

Though Spain has nowhere near the debt load of Greece and its banks are flush after taking advantage of low-interest loans from the ECB, Spain is seen as the next country on the brink because it has now entered a second recession, because of the toll that fiscal austerity plans will take on its economy going forward, and because of a tanking real estate market and the highest unemployment rate in the eurozone – nearly a quarter of the workforce, 5.3 million people, is unemployed, including half of its younger workers. Over the past month, the yields on Spain’s bonds have inched steadily upwards while those of Italy have stabilized. The new Prime Minister Mariano Rajoy is expected to unveil a budget this week that forecasts GDP falling 1.7% in 2012, and he has already told the EU that Spain will not meet its deficit target of 4.4% of GDP and will instead aim for 5.3%.

The day after Mr. Geithner and Mr. Bernanke weighed in, the closely watched survey of purchasing managers in Europe fell to 48.7 in March from 49.3 in February – any reading below 50 means contraction – indicating that the eurozone had slipped into a recession in the first quarter. Worse still, the survey showed a decline in manufacturing in Germany, Europe’s most stalwart economy, though it remained above 50 at 51.4, while France, Europe’s second largest economy, dropped to 49.0.

There was an equally unsettling report from China where a survey of purchasing managers in its factory sector in March fell to 48.1 from 49.6 in February; a reading below 50 means contraction there as well. In addition, new home prices in China posted their worst performance in a year in February as prices fell in 27 of 70 cities from a year earlier.

Meanwhile, there were mixed signals from other Fed board members about the state of the economy and the Fed’s policymaking plans. James Bullard,

president of the Federal Reserve Bank of St. Louis, said, “on pause, it may be a good time to take stock of whether we may be at a turning point” and indicated the Fed’s first interest rate increase since the global financial crisis could come as soon as late 2013. Mr. Bullard also said that “the outlook has improved markedly” and that the economy may grow by as much as 3% this year whereas most forecasters are estimating around 1.8%. On the flip side, William Dudley, the president of New York’s Federal Reserve Bank, said that while economic reports have improved, it’s “far too soon to conclude that we are out of the woods.”

In something of a surprise pick, President Obama named Jim Yong Kim, the president of Dartmouth College and an authority on global health issues, as his nominee to run the World Bank when the job opens up on June 30. Despite grumblings from some developing countries, Dr. Kim is all but assured of getting the job as the United States and Europe together have enough votes to carry the day – and Europe owes us, as we backed Christine Lagarde to run the International Monetary Fund. An American has headed the World Bank ever since it was created after World War II.

In other economic news, the Labor Department said that first-time jobless claims fell 5,000 to 348,000 last week, the lowest point since March 2008. The four-week moving average also tied a four-year low at 355,000.

The Conference Board reported that its index of leading indicators was up 0.7% in February after rising the same amount in January.

The Commerce Department said that building permits improved 5.1% in February to a seasonally adjusted annual rate of 717,000 units, their highest level since October 2008 (before anyone gets too excited, it’s worth noting that the all-time high was 2.27 million back in January 2006). Housing starts fell 1.1% to an annual rate of 698,000 but were up 34.7% year to year, the largest such increase since April 2010.

The Commerce Department also reported that sales of new homes fell 1.6% in February to a seasonally adjusted annual rate of 313,000 homes – a pace of 700,000 is considered the sign of a healthy real estate market. Looking for a silver lining? Well, the median sales price jumped 8.3% to \$233,700, the highest mark since last June.

Finally, flush with an estimated \$100 billion in cash, Apple announced it was going to start paying a dividend of \$2.65 a share later this year and also would spend \$10 billion to buy back its shares. How successful has Apple been of late? In the fourth quarter of 2011, sales were up 73% from a year earlier, and in the fourth quarter of 2010 they gained 70%.

A Look Ahead

In addition to the healthcare case that will be taken up by the Supreme Court this week, the first quarter will come to an end on Friday and investors will wait to see if the major stock indexes will stay on pace for one of the best opening quarters in years. There will also be updates on pending home sales, the Standard & Poor’s/Case-Shiller home price index, durable and capital goods, personal consumption, personal income and spending, and the revised number for fourth-quarter GDP growth which is expected to remain at 3%.



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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 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 World Bank is an international financial institution that provides loans to developing countries for capital programs. It is made up of two unique development institutions owned by 187 member countries.

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 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.

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.