



December 27, 2011

Whether it was simply a dose of holiday good cheer or the fact that the European Central Bank and Congress actually did something, the latter only after much angst, the major indexes surged last week, with the Dow hitting a five-month high and the S&P 500 moving back in the black for 2011. Of course, during this last trading week of 2011, investors will have to decide whether those early Christmas gifts were really what they wanted or if they should be returned. They may also resolve to be not so easily swayed by promises coming out of Washington, D.C. and Europe that are seldom what they're cracked up to be.

That said, the best Christmas gift for most Americans was that our politicians went home for the holidays so we don't have to listen to their bickering anymore in 2011. As everyone knows, before they left, members of the House finally gave in and approved the two-month extension of the Social Security payroll tax cut that will affect 160 million Americans. The Senate, in rare bipartisan fashion, had approved the extension the weekend before by a count of 89-10 with 39 Republicans voting yea, apparently having been told the House was on board with the short-term solution. Oops. It turned out that Speaker of the House John Boehner (R - Ohio) had lost control of his Tea Party troops who rejected the deal. Mr. Boehner then said that a two-month extension was "just kicking the can down the road," adding, "It's time to just stop, do our work, resolve our differences and extend this for one year." The result was that the Democrats got the rare opportunity to sit on the sidelines as Republicans from the Senate

	Key Market Data		
	Week ending...		
	12/16/11	12/23/11	Change
Dow Jones Industrial Average Index	11,866.39	12,294.00	+3.60%
S&P 500 Index	1,219.66	1,265.33	+3.74%
NASDAQ Composite Index	2,555.33	2,618.64	+2.48%
10-Year Treasury Note Rate	1.853%	2.026%	+0.173 pct. pts.
NYMEX Crude Future (Barrel)	\$93.53	\$99.68	+6.58%
Euro/U.S. Dollar	\$1.3043	\$1.3046	+\$0.0003

and the House went after each other. For example, Senator Scott Brown (R - Mass.) said, "The House Republicans' plan to scuttle the deal to help middle-class families is irresponsible and wrong." And on CNN, Senator John McCain (R - Ariz.) said, "It is harming the Republican Party. It is harming the view, if it's possible anymore, of the American people about Congress." The turning point seemed to come on Wednesday with an editorial in *The Wall Street Journal* entitled "The GOP's Payroll Tax Fiasco" that said the House was doing all it could to ensure President Obama's reelection: "The entire exercise is *political*, but Republicans have thoroughly botched the politics." Mr. Boehner then reversed course, adding that it might not have been "politically the smartest thing in the world" to hold up the tax cut with the holidays coming. As a result, the Social Security payroll tax will remain at 4.2% through the end of February and a bipartisan committee was created to negotiate a full-year extension. Further, Medicare will continue to pay doctors at the current rate, avoiding a 27% cut that had been scheduled for Jan. 1.

The bill also included a provision to speed the decision on the Keystone XL oil pipeline. After the bill was approved, President Obama said, "This is the right thing to do," adding, "This is real money that will make a real difference in people's lives."

In Europe, investors were upbeat after the European Central Bank offered loans to banks at a record-low interest rate of 1% for three years. On the first day 553 banks took advantage of the offer and borrowed some €489.19 billion (\$640 billion). The positive spin is that the banks will use that money to make loans and buy bonds. The negative take is that they need that money to survive and there will be no trickle-down for consumers looking for loans or countries selling bonds.

Earlier last week the ECB, in its twice-yearly report, said that European banks were in the midst of a crisis of "proportions not witnessed since the collapse of Lehman Brothers." Even so, ECB President Mario Draghi stood by his currency and its future: "I have no doubt about the euro," he said. "The one currency is irreversible."

The 17 eurozone members also agreed to contribute €150 billion (\$195.6 billion) to the International Monetary Fund (IMF) as part of a crisis response fund. They had committed to €200 billion at the recent meeting at Brussels but that total depended on a contribution from Great Britain, currently on the outs with the rest of the eurozone after having rejected the plan adopted in Brussels to increase the oversight of member economies. Britain is now not expected to decide whether or not it will kick in any money until next month.

Spain's new Prime Minister, Mariano Rajoy, made his first speech to Parliament and said that if Spain was going to reduce its budget deficit to below 6% of GDP by the end of next year it would have to shrink the country's public sector, stabilize its banks and introduce tax breaks for businesses to

stimulate spending. Rajoy's conservative party routed the incumbent Socialist government in November and has thus come in with a mandate to take drastic steps to resuscitate Spain's economy. Then, in a sign that investors were more upbeat about Spain's prospects under Rajoy, it sold €5.6 billion (\$7.3 billion) in bonds, more than originally intended after unexpectedly strong demand. Three-month bills sold at a 1.74% yield (down from 5.11% in November) and six-month securities at 2.44% (compared to 5.227%, also in November).

Italy's senate voted to approve the €40 billion austerity package that is intended to eliminate its budget deficit by 2013.

And Greece is said to be close to a deal with private creditors to restructure the €200 billion (\$260 billion) it owes them. The agreement, a voluntary part of the bailout plan for Greece, is said to cut that number in half, which would save Greece about €5 billion a year.

The former leader of the International Monetary Fund, Dominique Strauss-Kahn, was back in the news last week. At a meeting in Beijing, he took aim at Europe's politicians (though his words could apply to ours as well), saying that the failure to act decisively was "bleeding away, day by day, the remaining confidence investors may have in politicians being able to solve the crisis."

In other economic reports, the Commerce Department said that GDP for the third quarter had been revised down from 2% to 1.8%, mainly because of lower consumer spending which came in at 1.7% compared to the earlier figure of 2.3%. That was still better than the 1.3% GDP growth rate posted in the second quarter. The fourth quarter is expected to be the best of the year, with estimates running at high as 4%.

The Federal Reserve finally unveiled its plan to have America's largest financial

institutions, those with \$50 billion or more in assets, hold more money in reserve (5% of assets, up from 4%) and also make that money more accessible to help ward off another financial meltdown. Some of the details are still being worked out, as is the question of whether or not the rules would be even more stringent for the handful of the nation's biggest such institutions. In addition, the new rules will limit the amount of credit exposure an institution can have to one borrower and include a provision to have a standalone board to monitor a company's level of risk.

Meanwhile, some members of the Fed were hinting that, because of low inflation and high unemployment, the Fed may leave its benchmark rate unchanged until 2014 – it had previously said through mid-2013, an unusual enough commitment for the notoriously cautious Fed. Furthermore, the Fed has said it will discuss how to be more transparent about its rate decisions at its first meeting of 2012 on Jan. 24 and 25.

The Commerce Department reported that housing starts in November reached 685,000, their highest level since April 2010. The seasonally adjusted annual rate was 635,000, up 9% from October.

First-time jobless claims fell 4,000 to 364,000, the lowest point since April 2008. And unemployment went down in 43 states in November, the Labor Department reported, with the rate in three states up and the other four unchanged.

The National Association of Realtors (NAR) said that home sales rose a solid 4% in November, the second best performance of the year. Having reached an annual clip of 4.42 million, sales are currently on pace to at least exceed last year's disappointing total of 4.19 million homes sold, the lowest rate in over a decade. Somewhat alarmingly, the NAR said it had been off in its figures for 2007-2010, overestimating sales by 14.3%, which means some 2.9 million fewer homes

were sold than previously reported during that time.

The Conference Board's index of leading indicators was up 0.5% in November to 118 points, the seventh straight month of growth.

The Commerce Department announced that consumer spending increased only 0.1% in November, the same pace as in October. Adjusted for inflation, spending was up 0.2% while income rose 0.1%, the weakest reading since August. The Commerce Department also said durable goods orders improved 3.8% to \$206.99 billion, with the increase mostly driven by aircraft orders.

The Thomson Reuters / University of Michigan index of consumer confidence climbed to 69.9 points in December from 64.1 the month before, its highest level since June.

The venerable automaker Saab filed for bankruptcy after GM, which sold it last year, vetoed the financial involvement of a Chinese company (GM can veto such deals because it controls patents used by Saab.)

Finally, in the face of anti-trust suits from the government, AT&T gave up on its \$39 billion deal to buy T-Mobile USA, ending a nine-month battle.

A look ahead

Based on what happened Friday – the lightest trading day of 2011 – Wall Street stands to be relatively quiet this week as investors will wait and see if the major indexes can make it into positive territory for 2011. Beyond that, there will be very few releases, including the S&P/Case-Shiller home price index for 20 major metro areas and pending home sales.

Enjoy the holidays and have a happy New Year.

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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.

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 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 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.

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 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.

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.