Northwestern Mutual
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Weekly Market Commentary by Emmett Wright

December 12, 2011

	Key Market Data		
	Week ending…		
	12/2/11	12/9/11	Change
Dow Jones Industrial Average Index	12,019.42	12,184.26	+1.37%
S&P 500 Index	1,244.28	1,255.19	+0.88%
NASDAQ Composite Index	2,626.93	2,646.85	+0.76%
10-Year Treasury Note Rate	2.046%	2.056%	+0.010 pct. pts.
NYMEX Crude Future (Barrel)	$100.96	$99.41	-1.54%
Euro/U.S. Dollar	$1.3390	$1.3385	-$0.0005

After a long week of anticipation about what, if anything, European leaders would agree to do at their summit in Brussels, it turned out that Germany got its way by persuading 26 out of 27 European Union members to adopt a new and more stringent "fiscal compact" that, in the eyes of most observers, will head off the next financial crisis but not do much to address the one going on right now. The Germans managed to impose the greater economic responsibility on their fellow EU members that they had long been pushing, while Great Britain, the one member that didn't sign onto the new pact, is on the outside looking in. In the end, the progress in Brussels was enough to drive the stock market up for both Friday and the week, but not enough to dispel anxiety about slow growth and debt levels in Italy and Spain.

In the days leading up to the meeting, Italy's new Prime Minister Mario Monti told Italians, in an emergency decree, that he was introducing an austerity package that was essential to the survival of the state and the euro. The steps will cut the cost of government, address tax evasion and raise the retirement age with the goal of reducing the country's budget deficit by 2013. "If you want, call these the 'Save Italy' measures," he said. He also noted, "The huge public debt of Italy isn't the fault of Europe; it's the fault of Italians."

And Antonis Samaras, Greece's new leader, said he expected his country's economy to shrink 6% this year and that Greece would not meet its revised deficit target. He also believes Greece will still be in a recession through 2013, as he put it, "a European record."

Lately no week seems complete without some ill news from ratings agencies, and Standard & Poor's added to the pre-meeting pressure when it said that the credit ratings of 15 European nations, including France and Germany, were in peril unless the eurozone's economic issues were worked out. It was the first time France and Germany had received such a warning, which usually indicates a 50% chance of a downgrade within 90 days. Six of those countries put on alert have AAA ratings (Austria, Finland, France, Germany, Luxembourg and the Netherlands). The next day, Standard & Poor's extended the warning to the bailout fund should any of the countries contributing to it be downgraded. The Germans seemed to agree, but other eurozone leaders were predictably annoyed by both the message and the timing. After a meeting before the meeting, the leaders of Germany and France, Chancellor Angela Merkel and President Nicolas Sarkozy – collectively dubbed "Merkozy" by the press – pushed a new plan that would make it easier to sanction EU member nations that failed to meet requirements, for instance, limiting their deficits to 3% of GDP, while regulating how much debt they could take on. They also said that in the future private investors would not be asked to take a loss on any euro-denominated bonds as has been the case with Greece: "Greece is and will remain an exception," Merkel said. Sarkozy added, "The message to investors from across the world is that in Europe we pay back our debts." The wording covered "automatic and immediate sanctions" which are in fact already in the treaties but aren't enforced. It would, in essence, represent a ceding of national authority over economic matters to the leaders in Brussels.

Expectations for Brussels were further heightened by now-or-never quotes, some of them self-inflicted. President Obama, for instance, said, "If we see Europe tank, that obviously could have a big impact on our ability to generate the jobs that we need here in the United States," adding, "Europe is wealthy enough that there's no reason why they can't solve this problem." And Sarkozy himself said, "If we don't have an agreement Friday, there won't be a second chance."

When the agreement was announced, largely a signing-off on the Merkozy proposal, it was, amazingly, 20 years to the day after the original treaty to create the EU and the euro had been signed. Said Merkel, "It's interesting to note that 20 years later we have realized – we have succeeded – in creating a more stable foundation for that economic and monetary union."

The new agreement allows the European Court of Justice to override a member's laws if they break the rules – in other words, enforcement now has some teeth. It was the prospect of such interference in internal affairs that was the deal-breaker for Great Britain's Prime Minister David Cameron. In addition, EU members pledged to raise $270 billion that the International Monetary Fund could use to help member nations in peril and also advanced the date for the new and larger bailout fund, the European Financial Stability Facility, though the totals involved were short of what had been hoped for and there's also no timeline for exactly when the new plan will be in place. Lastly, despite the clamoring of many members, Germany also got its way in keeping the European Central Bank from playing a larger role in addressing the crisis (though the ECB did step up its purchases of Italian bonds last week). All along, Germany had argued that the long-term plan was more important than a short-term fix, and after the session Merkel said, "We will use the crisis as a chance for a new beginning." But critics say that the slow-and-steady approach will further crimp already-sluggish growth and not solve the near-term problems, meaning that it may soon be seen by the markets as nothing more than one more step that falls short.

In other action, the ECB lowered its benchmark rate for the second time in less than a month to try and boost economic growth, cutting it from 1.25% to 1%, back to a record-low level. The Bank of England kept its rate at its all-time low of 0.5%. The ECB also offered banks three-year loans for as much money as they needed, agreed to ease collateral criteria for loans to banks, and cut the reserve ratios of banks to 1% from 2%. However, the ECB's chief Mario Draghi said he was "surprised" that people had drawn that conclusion that he had opened the door to greater intervention in his comment's the week before.

And in further evidence that the crisis was far from over, on Thursday European regulators said that many of the region's biggest banks, including Deutsche Bank and Commerzbank, need to have more capital in reserve. The next day, Moody's downgraded France's three largest banks: BNP Paribas, Société Générale and Crédit Agricole.

In the United States, Congress continued to tussle over how to renew the Social Security tax break that's scheduled to end on Dec. 31, but both sides seemed to be doing all they could to thwart a deal. The Democrats' proposal included a surtax on millionaires, originally 3.25% but down to 1.9% in the latest version. "We are offering a serious proposal with meaningful concessions," said the Senate Majority Leader Harry Reid (D - Nev.) to which Senator Orrin Hatch (R - Utah) said, "With the long list of things Congress has to get done by the end of the year and the clock ticking, it's pretty mystifying that the majority is pursuing more political show-votes that won't go anywhere." The GOP's counter-plan coupled an extension with, among other addenda, approval of the proposed Keystone XL pipeline that would run from Canada to Texas and included cuts in social programs to pay for renewing the tax break. Reid's response echoed that of Hatch: "If the House sends us their bill with Keystone in it, they are just wasting valuable time because it will not pass in the Senate." In sum, business as usual in Washington.

In a sign that some progress could be made somewhere on hiking taxes, New York's Governor Andrew Cuomo managed to raise $1.9 billion by increasing taxes on his state's super-wealthy, those individuals making more than $2 million a year. This came despite the fact that Cuomo came into office vowing no new taxes, and in the end all 55 New York State Senate members, including 32 Republicans, voted in favor of the bill. But there was a catch that gave everyone cover: the new rate of 8.82% comes after a temporary tax hike on the rich to 8.97% that's expiring, and thus the new rate, while lower than the hike, was still higher than the original rate of 6.85%. Complicated math, but both parties were able to claim victory, which is all that mattered.

In other news, there continued to be some generally positive reports about the U.S. economy, which explains why the Thomson Reuters/University of Michigan consumer confidence index for early December hit a six-month high.

For starters, the Labor Department reported that first-time jobless claims fell to their lowest point since February, dropping 23,000 to 381,000. And the Commerce Department said that wholesale inventories climbed 1.6% in October, the biggest jump since May, after a 0.3% increase in September. The Commerce Department also reported that the trade deficit in October was down to $43.5 billion, though both imports and exports declined.

In another sign of success, and caution, the Fed reported that nonfinancial corporate businesses had a record $2.12 trillion in liquid assets during the third quarter, up $41 billion. In less-propitious news, the Fed also announced that the net worth of U.S. households fell $2.4 trillion in the third quarter to $57.4 trillion, the biggest drop since the fourth quarter of 2008 when the financial crisis was in full flight. And the Commerce Department said that orders for factory goods were off in October for the second month straight, this time down 0.4%.

Inflation in China in November was up 4.2% from a year earlier but down from 5.5% in October. That was the lowest reading since September 2010 and indicates that the Chinese can continue to shift their attention back to growth, as they have recently begun to do by lowering the size of the cash reserves that their banks are required to hold. China also weighed in on the euro crisis, deflecting the idea that it was going to come to Europe's rescue by contributing to the EFSF: "The argument that China should rescue Europe does not stand, as reserves are not managed that way," said Fu Ying, China's vice minister for foreign affairs.

A look ahead

This week, there will be updates on retail sales, business inventories, and the producer and consumer price indexes, as well as industrial production and capacity utilization. We'll also see how investors – and the ratings agencies – react after having the weekend to think about what happened in

Brussels. And on Tuesday the Federal Reserve will have its last meeting of 2011.

Correction: Last week Charles Schumer was mistakenly identified as the Republican Senator from New York when he is in fact a Democrat.

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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.

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.

Standard & Poor's (S&P) is a U.S.-based financial services company. As one of the Big Three credit-rating agencies, the company issues credit ratings for the debt of public and private corporations. It is one of several credit rating agencies that have been designated a nationally recognized statistical rating organization by the U.S. Securities and Exchange Commission.

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.

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.

Moody's Investors Service performs international financial research and analysis on commercial and government entities. The company also ranks the credit-worthiness of borrowers using a standardized ratings scale. It is one of the Big Three credit rating agencies and has a 40% share of the world market, as does Standard & Poor's; Fitch Ratings has a smaller share.