



*December 29, 2008*

## Weekly Market Commentary

Amid light trading conditions, the domestic equity market dropped a bit last week. Following a common weekly pattern, the market received a serving of dour economic news, yet managed to digest it without much upset.

The bulk of the domestic market's decline was suffered on Monday and Tuesday. Wednesday and Friday, on the other hand, saw some holiday cheer as the S&P 500 Index lifted somewhat. Crude prices reached \$37.71 a barrel, lifting the energy sector, after a four-session drop, and a 33% drop so far in December. Positive news about the approval by the U.S. Federal Reserve of General Motors Acceptance Corporation's application for debt relief provided a measure of support for the broader market.

Leading the week's news, November existing home sales declined 8.6% from October, and new home sales on an annualized basis hit their lowest level in 17 years. Prices were mixed, however, with existing homes continuing to be pressured lower by large discounts in this distressed market, while new homes saw some stabilization. Initial jobless claims surged to a 26-year high of 586,000, durable orders declined 1.0% in November, and personal income and personal spending fell 0.2% and 0.6%, respectively, in November.

**Key Market Data**

|                                    | Week ending... |          |           |
|------------------------------------|----------------|----------|-----------|
|                                    | 12/26/08       | 12/19/08 | Change    |
| Dow Jones Industrial Average Index | 8515.55        | 8579.11  | -0.74%    |
| S&P 500 Index                      | 872.80         | 887.88   | -1.70%    |
| NASDAQ Composite Index             | 1530.24        | 1564.32  | -2.18%    |
| 10-Year Treasury Note Rate         | 2.13%          | 2.12%    | +0.01%    |
| NYMEX Crude Future (Barrel)        | \$37.71        | \$33.87  | +\$3.84   |
| Euro/U.S. Dollar                   | \$1.4026       | \$1.3918 | +\$0.0108 |

We continue to witness confirmation that a recession is well under way. The third quarter picture continued to become clearer as more data was released last week. Real personal consumption expenditures knocked 2.8% off real Gross Domestic Product (GDP) growth – a key barometer for inflation-adjusted economic health – which delivered -0.5% for the third quarter. Slightly better than the consensus estimate of -0.6%, it still remained the biggest quarterly contraction since 9/11. Real final sales of domestic product – GDP less change in private inventories – were revised to -1.3% from -1.4%, in contrast to an increase of 4.4% in the second quarter.

Personal Consumption Expenditures (PCE) reflects the changing composition of spending compared to the Consumer Price Index's (CPI) fixed-basket approach. The decrease in real GDP in the third quarter

primarily reflected negative contributions from PCE, residential fixed investment, and equipment and software. These downward pressures were partly offset by positive contributions from federal government spending, private inventory investment, exports, nonresidential structures, and state and local government spending. Nonresidential structures were revised up from 6.6% to 9.6%, while equipment and software was revised down to -7.5% from -5.6%. Residential fixed investment was revised to -16.0% from -17.6%. The PCE for services was revised down to -0.1% from zero, its first decline since the first quarter of 1991.

Part of the reason third quarter GDP beat the consensus was the reduction in prices for banking services and new homes. Accordingly, the PCE Prices Index was revised to 5.0% from 5.2%. Similarly, gross domestic purchases prices were revised to 4.5% from 4.7%. The respective core measures were also each revised down by 0.2 points to 2.4% and 2.8%. Profits from current production were revised down to -1.2% from -1.0%. Adjusted after-tax profits were revised to -0.5% from -0.4%. Downward revisions to financial profits more than offset upward revisions to non-financial and overseas profits.

### **The broader view**

With the retrenchment in both consumer and business spending, and the global slowdown that is crimping demand for U.S. exports, we believe we will see a much larger decline for real GDP in the fourth quarter. It is possible we could see a contraction in fourth quarter GDP to just below -3%, while some economists are forecasting -6%. On the other hand, there is some ground for optimism about the state of the American consumer's mind. The Reuters/University of Michigan Consumer Sentiment Index rose

1.0 point from its mid-month reading, and 4.8 points from November to 60.1 in December. The consensus had been for sentiment to remain unchanged at 59.1. Current conditions were little changed from mid-month, but jumped 12.0 points since November, the biggest improvement since January 2004. Expectations improved 1.6 points from mid-month, recovering to November's level.

There are some more good tidings this season, too, from the inflation front. Inflation is now in a fairly bullish zone for the stock market. This has allowed real hourly earnings to rise to 3.1% over the past year, to its highest level since March 1979. Despite high unemployment, improvement in inflation and real earnings still represents an important economic step in the right direction. Real earnings yields, which were quite cautious a year ago, are now quite bullish for stocks despite falling earnings. In addition, the dividend yield on S&P 500 Stock Index versus the yield on the 10-year Treasury has never been more attractive.

We have mentioned the relative attractiveness of Treasury Inflation-Protected Securities (TIPS) when compared to the yield on conventional Treasuries for the past couple of months. We still believe that one way investors can hedge against both deflation and inflation concerns is through some exposure to TIPS. The underlying principal of TIPS increases with inflation and decreases with deflation, as measured by the Urban Consumer Price Index. If inflation occurs, the interest payment increases. In the event of deflation, the interest payment decreases. When a TIPS matures, investors are paid the adjusted principal or original principal, whichever is greater. This feature protects investors from deflation. Although TIPS yields have declined somewhat recently,

they still remain relatively attractive on a historical basis. Investors may want to consider allocating a portion of their fixed-income assets to these instruments. For more information on TIPS, please consult with your financial advisor.

### **A look ahead**

Is the last week of 2008 finally here? After a 40.6% drop year-to-date for the S&P 500 Stock Index, what will U.S. stocks accomplish in the final week? According to the Stock Trader's Almanac, the last five trading days of the year and the first two trading days of the New Year comprise the period that is measured to determine if Santa

Claus came to Wall Street. A net gain for the period is considered to be an affirmative reading, while a net loss is a negative one. Tipping the scales to the negative side will be some year-end tax selling undertaken by investors looking for some relief from equity exposure. However, we believe the final week of the 2008 is unlikely to be as tumultuous for stocks as the year has been to this point. Many advisors have completed their client reviews for 2008 and are in the process of adjusting investment strategies and rebalancing asset allocation mixes, where appropriate, in preparation for the brand new year ahead.



Emmett Wright, CFA  
Chief Investment Officer  
Northwestern Mutual Wealth Management Company

Emmett Wright is the Chief Investment Officer of The Northwestern Mutual Wealth Management Company. The opinions expressed are those of Emmett Wright as of the date stated on this report and are subject to change. There is no guarantee that the forecasts made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment or security. Investment involves risk. Investing in foreign markets involves currency and political risks. Information and opinions are derived from proprietary and non-proprietary sources.

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<sup>®</sup> 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<sup>®</sup> (S&P 500<sup>®</sup>) 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<sup>®</sup>). 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.

Northwestern Mutual Financial Network (NMFN) is the marketing name for the sales and distribution arm of The Northwestern Mutual Life Insurance Company, Milwaukee, WI (NM), and its subsidiaries and affiliates, including Northwestern Mutual Wealth Management Company, Milwaukee, WI. Northwestern Mutual Wealth Management Company, Milwaukee, WI, a wholly-owned company of The Northwestern Mutual Life Insurance Company (NM), is a limited purpose federal savings bank. Securities are offered through Northwestern Mutual Investment Services, LLC (NMIS), member FINRA and SIPC, a wholly-owned company of NM and a dually registered broker/dealer and registered investment adviser.

The NASDAQ Composite Index<sup>®</sup>. 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 FINRA 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 CBOE Volatility Index<sup>®</sup> (VIX<sup>®</sup>) is a key measure of market expectations of near-term volatility conveyed by S&P 500 Index option prices. VIX uses a weighted average of options with a constant maturity of 30 days to expiration.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. As of June 2007 the MSCI World Index consisted of the following 23 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

International Monetary Fund is an organization set up in 1944 to lower trade barriers between countries and to stabilize currencies by monitoring the foreign exchange systems of member countries, and lending money to developing nations.

The Reuters/University of Michigan Surveys of Consumers are monthly surveys of consumer attitudes and expectations about the U.S. economy. They provide a gauge of consumer anticipation of changes in the economic environment.

The Consumer Price Indexes (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.