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All of the major indexes – not to mention oil and the dollar – fell last week as the first reports of the earnings season disappointed investors and as President Obama and his fellow Democrats declared open season on the financial firms about to hand out billions in year-end bonuses.

Regarding fourth quarter revenues and earnings, all eyes were on two of the so-called “bellwethers” – companies that are seen as setting the stage for their respective industries – in this case Alcoa, for commodities, and Intel, for PCs. The news from Alcoa was a disappointment, the company losing \$277 million for the quarter, though revenues rose 18%, and earning only 1¢ per share as opposed to the projected 5-to-6¢. On Thursday, Intel announced that its last quarter profit was \$2.28 billion compared to \$234 million in the fourth quarter of 2008 as it also posted its highest gross profit margin ever (65%). Even so, in a sign of a tentative market, Intel’s shares fell 3.2% on Friday.

Similarly, JPMorgan Chase had a profit of \$3.28 billion in the fourth quarter compared to \$702 million a year ago, but investors were worried about its red ink on the consumer side where its retail banking unit lost \$400 million (compared to a profit of \$624 million in 2008); the investment bank, in contrast, had earnings of \$1.9 billion compared to a loss of \$2.4 billion in 2008. Overall, the bank earned \$11.7 billion for all of 2009 and generated record revenues, but its stock also fell on Friday, down 2.3%. Expectations are for operating earnings to triple year-on-year for companies in the

	Key Market Data		
	Week ending...		
	1/15/10	1/8/10	Change
Dow Jones Industrial Average Index	10,609.65	10,618.19	-0.08%
S&P 500 Index	1,136.03	1,144.98	-0.78%
NASDAQ Composite Index	2,287.99	2,317.17	-1.26%
10-Year Treasury Note Rate	3.676%	3.808%	-0.132 pct. pts.
NYMEX Crude Future (Barrel)	\$78.00	\$82.75	-5.74%
Euro/U.S. Dollar	\$1.4379	\$1.4417	-\$0.0038

S&P 500, but at this stage of the recovery, investors are not just looking for earnings from cost cutting; they’re looking for rising revenues and other signs of progress such as capital spending and hiring. (For the record, revenues for companies in the S&P 500 have not gone up since the second quarter of 2007.)

In other economic news, the trade gap – broadly speaking, the difference between the cost of what the United States imports and what it exports – widened more than expected in November, though that can be construed as good news for those who hope that American consumers are starting to spend again. Riding a 2.6% increase in imports, the deficit swelled to \$36.4 billion, up 0.7% from October, mainly because of the higher cost of imported oil. Exports were up 0.9% from October to \$138.2 billion, the highest total of 2009 so far, though a slower rate than in the previous two months.

The Federal Reserve released its Beige Book report for its 12 regions, reporting that, “while economic activity remains at a low

level, conditions have improved modestly further, and those improvements are broader geographically than in the last report.” The Fed saw modest improvement in 10 of its 12 regions (up from eight in its previous report). However, the Fed added that consumers are still “cautious, price sensitive and focused on necessities” and labor conditions remained “soft” in nearly all Fed districts, as did commercial and industrial real estate. Above all, for Fed watchers, there didn’t seem to be any data to support a rise in either inflation or the Fed’s rate.

Later in the week, the Fed’s take on inflation was underscored when the Labor Department said that its Consumer Price Index rose a modest 0.1% in December from November. If any further evidence was needed that inflation is in check, the average index for all of 2009 was 0.4% lower than in 2008, the first full-year drop since 1955. The Core Price Index, excluding food and energy, was up 0.1% in December and 1.8% for 2009.

There was more mixed news from the Fed last week as overall industrial production in December was up 0.6% for the second month in a row but off 2.0% for all of 2009. Manufacturing production fell 0.1% after a 0.9% rise in November and was down 1.9% for the year. Lastly, industrial capacity utilization inched up 0.5% from November to 72% in December, but remained well below the average of 80.9% from 1972 through 2008.

Despite early reports that indicated otherwise, the Commerce Department said that retail sales totaled \$353 billion in December, down 0.3% from November (a 0.5% rise had been expected), a sign that the job market, coupled with higher hurdles to borrowing, continues to make consumers wary about spending. On the plus side, total sales were up 5.4% from December of 2008.

The Commerce Department also reported that business inventories rose 0.4% in November, above the forecast and a sign

that companies may be restocking their shelves in anticipation of higher demand. That was the same rate of improvement as in October, the first back-to-back increases in over a year.

Overseas, in another sign that the European economic recovery is still sputtering, Germany announced that its GDP growth for 2009 fell 5%, its worst performance of the postwar era and bad news for a country that not only has Europe’s biggest economy, but the world’s fourth largest.

The broader view

2009 was not merely a bounce-back year for many of America’s top financial firms, some of which seemed on the precipice just 12 months ago, but one in which many of those firms posted record returns – and put aside a record sum for bonuses. *The Wall Street Journal* has calculated that the top 38 banks are going to award a record \$145 billion, up 18% from last year’s total of \$123.4 billion and even better than in 2007. And it’s been estimated that Goldman Sachs’ employees will get an average of \$595,000 and those at JPMorgan Chase \$463,000.

Politicians, as well as the firm’s executives, are well aware that most Americans, still in the grip of the recession, will not take kindly to outsized bonuses, especially for companies – and by extension, an industry – that was bailed out by taxpayer dollars. So this year many of the biggest firms are announcing modest changes, as Goldman Sachs did recently when it said its top 30 executives would get their bonuses in stock, not cash (the firm is also said to be weighing a requirement whereby its employees will have to give a percentage of their bonuses to charity). Even so, those moves have not stemmed the gathering tide of resentment (keeping in mind that no bonuses have been awarded yet), not to mention the accompanying political theater.

On CNN last Sunday, Christina Romer, head of the White House Council of Economic

Advisers, said, “You would certainly think that the financial institutions that are now doing a little bit better would have some sense.” And even one of their former peers, John S. Reed, a founder of Citigroup, joined the chorus: “There is nothing that I’ve seen that gives me the slightest feeling that these people have learned anything from the crisis,” he said. “They just don’t get it.” New York Attorney General Andrew Cuomo entered the fray on Tuesday, asking for information about compensation and bonuses for firms in New York that received money from the Troubled Asset Relief Program (TARP), including Bank of America, Goldman Sachs, JPMorgan Chase, and Wells Fargo.

Then on Wednesday, leaders of four the nation’s biggest firms appeared before the 10-member, bipartisan Financial Crisis Inquiry Commission in Washington where they were compared to shifty car salesmen. The bankers did shoulder some of the blame (“There is no doubt that we as an industry made mistakes,” said Morgan Stanley’s Chairman John Mack), but they insisted that federal policy makers and the economy were also complicit.

The next day, President Obama, saying he wanted “to recover every single dime the American people are owed” for bailing out the economy, introduced a proposal known as the Financial Crisis Recovery Fee. The fee would assess the 50 financial companies with assets of \$50 billion or more so that they would pay back over the next decade the estimated \$117 billion in federal money lost during the bailout (even though the financial firms, unlike GMAC, for example, have paid back the TARP money they borrowed). While unveiling his proposal, the president had warning words for Wall Street: “Instead of sending a phalanx of lobbyists to fight this proposal or employing an army of lawyers and accountants to help

evade the fee, I’d suggest you might want to consider simply meeting your responsibilities.” He added, “We want our money back, and we’re going to get it.”

So far, Republicans have remained mute about the fee, perhaps not wanting to be in the position of defending bank bonuses with midterm elections looming. Or perhaps they’re willing to bide their time because most of the proposed bills to reform the financial system have stalled in Congress and any pushback might prod legislators to consider a 50% tax on year-end bonuses of more than \$50,000 at banks that received TARP money, as some Democrats have proposed.

A look ahead

This is a short week with the stock market closed on Monday for Martin Luther King Jr.’s birthday and little in the way of releases, though there will be updates on housing starts and the Producer Price Index. Investors will be more interested in the next wave of earnings announcements (and the market’s response to them), with reports due from IBM, Citigroup, Morgan Stanley, Bank of America, and Starbucks, among others.

Meanwhile, despite a wobbly week for the stock market, investors have begun to receive their year-end statements and are breathing a sigh of relief after the bloodbath of 2008. However, the stock-market’s nine-month surge has done more than rebuild confidence and portfolios; it has also seen some asset classes get ahead of themselves (high yield bonds are a good example, no longer appearing as cheap as they were during their record run of 2009). As a result, it’s time for investors to review and rebalance their portfolios and make sure that their asset allocation is still in line with their long-term investment goals.

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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 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 Beige Book, more formally called the Summary of Commentary on Current Economic Conditions, is a report published by the Federal Reserve Board eight times each year. It is a summary of economic conditions in each of the Fed's regions.

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.

The Core Price Index is a method for measuring core inflation while excluding energy and food prices, which are very volatile.

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services.