



June 21, 2010

The Greeks were celebrating last week while the Spaniards were utterly deflated – but that was only on the soccer pitch where Greece won its first World Cup game ever and Spain, one of the favorites, was beaten by the Swiss. Off the field, it was more of the same for Greece, which saw its credit rating reduced to junk status. Spain, however, had a successful bond sale that gave investors a much-needed respite and drove all three indexes up at least 2% for the week and in the black again for 2010, if still well off their highs of April.

The Federal Reserve reported that industrial production rose 1.2% in May (from a revised 0.7% in April) as the global demand for American products increased, and the Conference Board said its index of leading indicators rose 0.4% in May. Automobile sales continued to be a bright spot as Toyota announced last week that it would resume construction of a plant in Mississippi that had been put on hold, while GM said it would be skipping its annual two-week summer shutdown (to get production lines ready for new models) to catch up with demand.

The Labor Department said that consumer prices fell 0.2% in May for the second month in a row, mainly because the price of gas went down 5.2%, its biggest monthly drop this year. The core consumer price index, which excludes the volatile food and energy categories, rose by 0.1% in May after being flat in April. Year to year, the core price index has risen only 0.9%, the lowest annual rate since 1966, while the overall index was up 2% from last May. The Labor

	Key Market Data		
	Week ending...		
	6/18/10	6/11/10	Change
Dow Jones Industrial Average Index	10,450.64	10,211.07	+2.35%
S&P 500 Index	1,117.51	1,091.60	+2.37%
NASDAQ Composite Index	2,309.80	2,243.60	+2.95%
10-Year Treasury Note Rate	3.225%	3.218%	+0.007 pct. pts.
NYMEX Crude Future (Barrel)	\$77.18	\$73.78	+4.61%
Euro/U.S. Dollar	\$1.2374	\$1.2094	+\$0.0280

Department also announced that first-time unemployment claims rose 12,000 to 472,000 for the week ending June 13, though the four-week moving average was essentially unchanged – down 500.

With the Federal Open Market Committee (FOMC) getting ready to meet this week, there was another indication that any increase in its federal funds rate may now be put off until 2012. A research paper from the Federal Bank of San Francisco – not an official policy statement, but nothing the Fed does is unconsidered – suggested that later timetable based on low inflation and high unemployment, adding that it was easier to wait and then raise rates more rapidly than it was to reverse course once rates had been increased. While the FOMC is not expected to raise its rate this week, its members will discuss the possibility of a double-dip and deflation, as well as the ongoing impact of the European debt crisis on the United States.

There continued to be very little in the way of positive news for the housing market as

the National Association of Home Builders said its index of confidence in new home sales fell to 17 in June from 22 in May. Any reading under 50 means the majority of respondents see conditions as poor, and it was last over 50 in April 2006. And the Commerce Department reported that construction of new homes and apartments dipped 10% in May as single-family home construction was off 17%. Further, applications for building permits were down 5.9% to the lowest point this year. Taken together, these numbers suggest that more people had acted to take advantage of the homebuyer's tax credit that expired in April than previously thought.

In Washington, congressional mediators continued to battle over reconciling the House and Senate versions of the financial overhaul bill, falling behind the schedule that would see the bill become law by July 4. In an article on the state of the negotiations, *The Wall Street Journal* reported that at one point Senator Christopher Dodd (D – Conn.) put an imaginary gun to his head and pulled the trigger. “My own fear,” Dodd said, “is that we’ve all died and this is our purgatory.”

In a further sign of partisan deadlock, the \$105 billion package to extend jobless benefits was held up by a Senate filibuster by the Republicans, with GOP leader Mitch McConnell of Kentucky saying, “Let’s not wave on through legislation that is going to worsen the deficit and dig an even deeper hole.” Former Federal Reserve Chairman Alan Greenspan also weighed in on the deficit in an op-ed piece in *The Wall Street Journal*, writing, “Only politically toxic cuts or rationing of medical care, a marked rise in the eligible age for health and retirement benefits, or significant inflation, can close the deficit.” He also opined that “the United States, and most of the rest of the developed world, is in need of a tectonic shift in fiscal policy.”

Meanwhile, BP had another PR disaster after its CEO Tony Hayward went before a

congressional committee and refused to accept direct responsibility for the oil spill in the Gulf of Mexico. Even so, the company agreed to an unprecedented \$20 billion bailout fund for damage claims and also cancelled dividends for the next three quarters.

Abroad, as noted, Greece had its debt rating downgraded to junk level (Ba1), but Spain successfully auctioned bonds at a higher-than-expected rate, which was a relief to investors – and to the euro. Also last week, France said it was going to act to reduce its deficit by cutting public spending and raising the retirement age, though it remains to be seen how its government will withstand the onslaught of the civil servants, labor unions and opposition parties that are mobilizing to protest.

Angela Merkel, the Chancellor of Germany, and Nicolas Sarkozy, the President in France, met in Berlin last week to try and patch up their differences over economic policy, which some observers see as having exacerbated the current crisis, with Sarkozy saying, “More than ever, Germany and France are determined to speak with one voice.” Soon afterwards, the European Union announced it would release the results of “stress tests” for its 25 biggest banks, which Germany had been dead-set against. (Stress tests are designed to project how well banks would hold up during economic downturns.) The hope is that the willingness of the banks to be open will offset any bad news that may turn up. José Manuel Barroso, president of the European Commission, the EU’s executive agency, said the decision “should reassure investors by either lifting unfounded suspicion or by dealing with remaining problems that may exist.”

The broader view

The United States was feeling like the world was against it when a goal against Slovenia was inexplicably taken away last week, and President Obama is also beginning feel like

he's been abandoned given the recent action – or inaction – of China over its currency and the loss of momentum for some of his global economic initiatives as he heads to Toronto for this weekend's Group of 20 (G-20) summit. For instance, Mr. Obama and Treasury Secretary Timothy Geithner decided to put off officially branding China a "currency manipulator" back in April in the hope that there would be a gradual shift in China's monetary strategy of tying the renminbi to the dollar (and thus making Chinese exports cheaper) as long as China wasn't feeling bullied. But the European market is China's biggest for exports, and the dip of the euro has already taken a toll on China's profit margins, so there's little reason to expect China to act anytime soon. In fact, on Thursday a Chinese government spokesman ominously said its currency was "not an issue the international community should discuss." As a result, Congress is making noise, with Sander Levin (D – Mich.), who leads the House Ways and Means Committee, saying, "If China does not act [in Toronto] and the administration does not respond promptly thereafter, the Congress will act." What can be done to move China, however, is open to debate.

Worse still for the president and his policies, the European Central Bank suggested that the time had come for governments to reduce their stimulus spending, concluding that that will lead to economic growth in the long term, even if there is a temporary slowdown, a theory that the Obama



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

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administration does not share. Feeling that some of his initiatives for global economic reform, such as a bank tax and capital and liquidity requirements for banks, were falling by the wayside, Mr. Obama sent a letter to his fellow G-20 leaders in advance of this weekend's meeting to try and build consensus and regain some momentum. "Our highest priority in Toronto must be to safeguard and strengthen the recovery," he wrote, adding that we need to learn from past mistakes where stimulus was withdrawn too soon, leading to "renewed economic hardships and recession." In his letter, he also vowed to cut our deficit from almost 10% of gross domestic product (GDP) in 2010 to 5% by 2013 and 3% by 2015.

A look ahead

The World Cup will still be in full swing this week, but investors will have two other important events that will vie for equal airtime: the meeting of the FOMC on Tuesday and Wednesday and the G-20 leaders in Toronto on Saturday and Sunday. In addition, there will be updates on new and existing home sales, durable goods, personal consumption and annualized GDP.

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