



July 6, 2010

So much for a holiday celebration.

The stock market reached the midyear mark with a fizzle, not a bang, as a raft of grim economic news about manufacturing, housing, cars and jobs put the recovery into a near stall and made investors and economists wonder if the correction was going to turn into a double-dip or even, some opined, a full-fledged depression. It was, improbably, the worst week for the Dow leading up to the Fourth of July since 1896. In fact, last week the Dow fell every day on its way to a low for 2010. As a result the Dow was off 4.51% for the week, the S&P 500 5.03%, and the NASDAQ 5.92%. And for the quarter, the Dow, S&P 500 and NASDAQ lost, respectively 9.36%, 11.43% and 11.83%.

The week began with the Commerce Department reporting that consumer spending, the key driver of growth, rose 0.2% in May after being all but flat in April, while incomes improved 0.4%, the fifth increase in the last seven months. However, the money that consumers spent on goods actually declined as the increase came largely from spending on services such as electricity (as in air conditioning). The savings rate climbed to 4%, and wages and salaries were up 0.5%.

On Tuesday, the Conference Board said that consumer confidence tumbled to 52.9 in June from 62.7 in May (a reading of 100 or more signifies strong growth.) That was the largest drop since February and the index had been up every month since then. Both components of the index – how consumers

	Key Market Data		
	Week ending...		
	7/2/10	6/25/10	Change
Dow Jones Industrial Average Index	9,686.48	10,143.81	-4.51%
S&P 500 Index	1,022.58	1,076.76	-5.03%
NASDAQ Composite Index	2,091.79	2,223.48	-5.92%
10-Year Treasury Note Rate	2.977%	3.119%	-0.142 pct. pts.
NYMEX Crude Future (Barrel)	\$72.14	\$78.86	-8.52%
Euro/U.S. Dollar	\$1.2565	\$1.2386	\$.0179

felt about the economy now and where they thought it would be in six months – fell, though it’s still a long way from the record low of 25.3 in February 2009.

Though analysts had been bracing for bad news about housing once the homebuyers’ tax credit expired at the end of April, last week’s news was still jarring when the National Association of Realtors said that after three months of increases, the index for pending home sales fell a record 30% in May and was off 16% from a year earlier. The Commerce Department followed that up by reporting that spending on construction in May fell 0.2% after a 2.3% improvement in April. The Standard & Poor’s/Case-Shiller home price index of housing in 20 major metropolitan areas was up 0.4% in April with 18 of the 20 cities improving month to month, though, again, many analysts discounted the number as being a one-time boost from the now-expired tax credit.

Meanwhile, auto sales, which have been a strong suit for the economy for some time, also took a turn south, falling 11% in June to

938,738 as the annualized rate dropped from 11.6 million to 11.1 million. Sales were still up 14% year-to-year and, compared to June of last year, Chrysler's sales jumped 35.4%, Ford's 13.4% and GM's 11.9%.

The Commerce Department said that orders for manufactured goods declined 1.4% in May, the largest drop since May of last year, after a 1% rise in April. Excluding transportation, new orders fell by 0.6%. And the Institute for Supply Management (ISM) reported that its manufacturing index for June fell to 56.2 from 59.7 in May, though any reading above 50 indicates growth.

As stocks fell, investors continued to seek safe haven in U.S. Treasury bonds with the yield on the benchmark 10-year note falling below 3% for the first time since April 2009 and the two-year note hitting an all-time low of 0.6%. The lower yield also sent mortgages down, and Freddie Mac's 30-year mortgage rate was 4.69%, the lowest rate since it began tracking the data in 1971.

The week ended with the Labor Department announcing that the jobless rate for June fell from 9.7% to 9.5%, news that pleased no one as the decline was the result of 625,000 people leaving the workforce. The private sector added 81,000 jobs, while nonfarm payrolls dropped for the first time this year, off 125,000, mainly because 225,000 census workers hired by the federal government were done with their work. All told, the economy has lost 7.4 million jobs since the recession began in December 2007, and the median duration for the unemployed rose to yet another record high of 25.5 weeks. The underemployment rate, including those who have given up looking and those who work part time but would prefer full time, is now 16.5%. A separate report by the nonpartisan Pew Research Center said that of the 13 recessions since the Great Depression, "none has presented a more punishing combination of length, breadth and depth."

For those looking for some glimmers of hope, here they are: during the first half of 2009, we lost 3.7 million private sector jobs, while in the first half of 2010 we added 590,000; and the manufacturing sector added another 9,000 jobs in June, making it 136,000 this year.

Though negotiations on the financial overhaul bill were supposed to be over, they were reopened when Democrats began to realize that they might not be able to muster the 60 votes needed in the Senate to move the bill to a vote, especially after the death of Senator Robert Byrd (D - W. Va.) left them with only 58. In an attempt to woo back Senator Scott Brown (R - Mass.), whose ye vote had helped pass the bill the first time around, the \$19 billion in taxes on banks that would be used to pay for part of the new regulation was dropped. Even so, while the House passed the revised bill on Wednesday by a vote of 237 to 192 (with only three Republicans voting for it and 19 Democrats voting against it), the Senate did not vote before the holiday weekend as President Obama had hoped. "If this bill were to fail," said House speaker Nancy Pelosi (D - Calif.), "we would be preserving a status quo that has left our economy in a wretched state." Mr. Obama, on the road in Wisconsin, took a more direct shot at the GOP, saying, "They think that our economy will do better if we just let the banks or the oil companies or the insurance industry make their own rules."

The European Union tried to reassure investors by saying that it would triple the number of banks it would subject to public stress tests from 22 to 60 or more, but Germany, which is against releasing the results of the tests, said it might not comply. However, later in the week Spain had a successful bond sale only a day after Moody's had warned of a debt downgrade, giving the euro a much-needed boost.

## The broader view

As bleak as the picture may be right now, we believe that the intense focus on deficits and jobs, however appropriate for the long term, is distracting investors from some notable positives – improved earnings and stronger fundamentals. Yes, the possibility of a double-dip has increased of late, but we continue to think that scenario is unlikely, as is the possibility of a deflation-induced recession (or worse). Given the excesses leading up to the crash, we have a lot to recover from, and it will take time. The most likely course for the stock market for the rest of 2010 and into 2011 is slow and modest growth, but growth nonetheless; we'll muddle through.

That said, what's an investor to do? Not surprisingly, our answer remains the same: have a plan in place and diversify. Though there are few places for investors to hide right now, those who leapt back into equities last year after the market was in full recovery mode have suffered the most. A look at the [chart below](#) underscores how riskier assets of every stripe have suffered, but also shows that diversification into all nine asset classes that we follow would have eased, if not eliminated, the pain. Trying to

time the market is no substitute for taking full advantage of the market by investing in the entire range of asset classes that can offset each other, particularly when stocks take a nosedive as they have of late. A perfect example of the benefits of diversification: At the beginning of the year, there was near unanimity that U.S. Treasuries would be a weak bet for 2010; as of the midway point, they have outperformed equities.

## A look ahead

This will be a slow week as the stock market was closed Monday and there will only be a few new reports – on non-manufacturing services, wholesale inventories, consumer credit and mortgage applications. That should lead to lower trading volumes and less volatility, perhaps giving investors, and the stock market, a chance to take a deep breath.

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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<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.

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 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 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 (Metropolitan Statistical Areas or MSAs), which are also aggregated to form two composites – one comprising 10 of the metro areas, the other comprising all 20.

# Asset Class Returns as of 6/30/2010

## Total Return Performance

<b>Large Cap</b> Russell 1000	<b>(6.40)%</b>
<b>Mid Cap</b> Russell Mid Cap	<b>(2.06)%</b>
<b>Small Cap</b> Russell 2000	<b>(1.95)%</b>
<b>Developed Markets</b> MSCI EAFE	<b>(12.93)%</b>
<b>Emerging Mkts.</b> MSCI EM	<b>(6.04)%</b>
<b>Commodities</b> DJ UBS Commodity	<b>(9.60)%</b>
<b>Real Estate</b> FTSE NAREIT	<b>5.56%</b>
<b>Fixed Income</b> BarCap US Agg Bond	<b>5.33%</b>
<b>Cash</b> 3 Month T-Bill	<b>0.05%</b>