



August 9, 2010

For the second Friday in a row, investors had to digest some sour news – two weeks ago the underwhelming 2.4% gross domestic product figure for the second quarter and last week the disappointing jobless rate, unchanged at 9.5% – and for the second week in a row the Dow nonetheless finished in the black, this time up a solid 1.79% thanks to a jump of 208.44 points on Monday. Taken together, the two reports revived talk about a jobless recovery at the same time that deflation has become a hot topic, setting the stage for this Tuesday’s meeting of the Federal Open Market Committee.

The week began with qualified cheerleading from both Federal Reserve Chairman Benjamin Bernanke and Treasury Secretary Timothy Geithner. In a speech in South Carolina on Monday, Mr. Bernanke conceded that the U.S. economy still had a “considerable way to go” before being fully recovered, but he also said that “rising demand from households and businesses should help sustain growth,” adding that consumer spending “seems likely to pick up in coming quarters.” And making it clear that the Fed is not likely to raise its benchmark lending rate anytime soon – indeed, some analysts are now saying the rate will remain at its record low for another year or even two – he said, “We need to make sure that monetary policy continues to provide the support the economy needs until we begin to see sustained growth and particularly growth in jobs.”

	Key Market Data		
	Week ending...		
	8/6/10	7/30/10	Change
Dow Jones Industrial Average Index	10,653.56	10,465.94	+1.79%
S&P 500 Index	1,121.64	1,101.60	+1.82%
NASDAQ Composite Index	2,288.47	2,254.70	+1.50%
10-Year Treasury Note Rate	2.826%	2.909%	-0.083 pct. pts.
NYMEX Crude Future (Barrel)	\$80.70	\$78.95	+2.22%
Euro/U.S. Dollar	\$1.3293	\$1.3033	+\$0.0260

The next day Secretary Geithner wrote an Op-Ed piece in *The New York Times* that was even more broadly optimistic, with the title, “Welcome to the Recovery.” Mr. Geithner included a long list of positives including increased exports, private job growth, the fact that businesses have “repaired their balance sheets,” Americans are saving more, and both the auto industry and banks have rebounded. While admitting that this was “cold comfort” to those looking for work, he also said that the administration’s actions helped save 8.5 million jobs and boosted GDP by 6.5%, with government spending delivering a “powerful bang for the buck.”

In other economic news, the Institute for Supply Management (ISM) reported that manufacturing grew yet again in July though the rate slowed to 55.5 from 56.2 in June as businesses were no longer rebuilding inventories at the same clip. Even so, any reading above 50 signals growth and manufacturers also expressed a new willingness to hire. Later in the week, the Commerce Department said that factory

orders fell 1.2% in June and May's decline was revised downward from 1.4% to 1.8%. And ISM reported that its service sector index rose to 54.3 in July from 53.8 in June (the service sector accounts for 80% of U.S. jobs).

The government announced that consumers saved 6.4% of their after-tax income in June compared to a rate of 1-to-2% before the recession began, though there's concern that the new frugality will hold back the recovery which is so dependent on consumer spending. Along those lines, the Commerce Department announced that consumer spending was flat in June, the first time this year it hasn't risen month-to-month. And Thomson Reuters said that same store retail sales rose only 2.9% in July, less than anticipated, especially as they were down 5.1% last July. Lastly, the National Association of Realtors said the number of pending home sales fell 2.6% in June and were off 18.6% from a year ago.

The brightest spot in the economy last week was the automotive industry where sales were up 5.2% from last July and more vehicles were sold than at any time since the cash-for-clunkers program ended last summer. Analysts also latched onto the fact that the sales of full-size pick-ups jumped 29% as that usually means contractors are working or expect to be working soon. On a related note, Edward Whitacre Jr., the chief exec of GM, said he was hoping to put up for sale the government's 61% stake in the company in its upcoming IPO, saying, "We don't want to be known as Government Motors."

The week closed with the latest on jobs – which was, in effect, more of the same. Though private employers added 71,000 new positions in July, they could not offset the nearly 200,000 state and federal jobs that came to an end and the unemployment rate remained at 9.5%, that's 14.6 million people, while the underemployment rate was also unchanged at 16.5%. Worse still, the

number of unemployed for June was upped from 125,000 to 221,000 and private sector hiring for that month was pared from 83,000 to 31,000. The only positive glimmers were the fact that the average number of hours worked inched up to 33.5 in July from 33.4 in June and the number of people out of work for 27 weeks or more fell from 6.8 million to 6.6 million. All in all, the report sent investors scrambling for safety, driving the yield on the two-year Treasury to a new record low of 0.514% while the yield on the 10-year hit its lowest point since last April of 2009 at 2.82%.

The news from Europe continued to be largely positive with two of the continent's biggest banks, BNP Paribas and HSBC, both reporting better-than-expected profits while Greece was given the go-ahead to get its next bailout installment of €9 billion (\$12 billion) based on its having made progress in restructuring pensions and overhauling its tax system. Meanwhile, Spain, Portugal, and Italy all had successful bond sales and the euro, which had dipped to \$1.19 in June, was back up to \$1.33 by week's end.

### **The broader view**

Senate leaders announced last week that the debate over whether or not to renew the Bush-era tax cuts will happen after the summer recess, setting the stage for some pre-election sparring. The battle is shaping up along the usual lines: the Democrats say the Republicans are protecting the rich while the GOP says the Democrats want to hike taxes. The administration has announced that it wants to let the tax cuts for the wealthiest 2% of Americans expire but extend those for filers who make less than \$250,000 as a family or \$200,000 as individuals. Secretary Geithner weighed in with some stats, saying that extending the tax cut to the wealthy would "require us to borrow \$700 billion more in the next decade, adding significantly to an already unsustainable level of debt," and also indicating to foreign investors that we're not yet ready to take deficit-cutting seriously.

Geithner also said that the Republican case that tax cuts pay for themselves “is a political argument masquerading as substance.” President Obama, describing America’s economy as a car, said, “Somebody pointed out to me that when you’re in your car and you want to go forward, you put it in ‘D.’ You want to go back in the ditch? You put it in ‘R.’” Later in the week, the call to let the tax cuts for the rich expire was echoed by a man whose endorsement had been key to their having been passed by Congress in the first place: Alan Greenspan, the former Fed chairman. Mr. Greenspan said, “I am in favor of tax cuts, but not with borrowed money.” And taking a much darker view than his successor Mr. Bernanke, he also said, “The problem we now face is the most extraordinary financial crisis that I have ever seen or read about.”

### **A look ahead**

With the dog days of summer upon us, get ready for more of the same – not a double-dip, but slower than usual growth that’s not enough to create jobs and requires the government to keep priming the pump, a state that commentators have taken to



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

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calling the “new normal,” and not an easy concept to accept in a country where we have always taken growth to be the norm. As Laura Tyson, the chief economic advisor to former President Bill Clinton said, “I think we’re going to have slower growth, a higher household savings rate and an elevated unemployment rate for several years.”

This week, there will be updates on second quarter productivity, retail sales, and the consumer price index, which will be closely watched for any signs of deflation. As noted, the Fed will meet on Tuesday, and while there’s virtually no chance that it will raise its rate, analysts and investors will be on the alert for any signs of “QEII” – a second round of quantitative easing to combat deflationary pressure.

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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.

ISM Index is a monthly index released by the Institute of Supply Management which tracks the amount of manufacturing activity that occurred in the previous month.

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