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FIRST Trust ADVISORS L.P.

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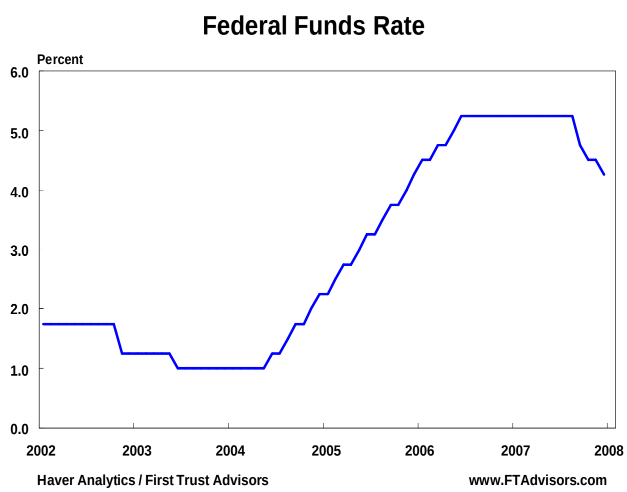
Economic Commentary

Fed Moves Again in December

Today the Federal Reserve cut both the federal funds rate and discount rate by 25 basis points. The funds rate is now 4.25%; the discount rate is now 4.75%.

Before the rate cut, the markets were split between expecting a 25 basis point rate cut, and one of 50 bps. Many thought that if the Fed held back and cut the funds rate by a smaller 25 bps., it would cut the discount rate by a larger 50 bps. As a result, the Fed action is being perceived as a negative for the economy and stocks.



Although the Fed disappointed those supporting larger cuts, it's statement leaves the door wide open for more. The paragraph on economic growth was *much* more bearish than in late October. The Fed noted "economic growth is slowing" and added "softening in business and consumer spending" to "the intensification of the housing correction" as a reason for the slowdown. Also, the Fed inserted a sentence on increased strains in financial markets and deleted a clause suggesting recent rate cuts would forestall some of the "adverse effects" of financial market strains on the "broader economy." Translation: The Fed is worried.

Rather than adding a true balance of risks to its statement, the Fed fell back on its September language and instead highlighted uncertainty surrounding the economic outlook.

Having cut the funds rate by a total of 100 bps. since August, the Fed has now cut rates by more than it did in reaction to either the stock market debacle in 1987 or the financial market crisis in 1998. Boston Reserve Bank President Eric Rosengren dissented in favor of a 50 bps. cut, while Kansas City President Thomas Hoenig agreed to the 25 bps., after dissenting at the October meeting in favor of no rate cut.

Partial Text of the Federal Reserve's Statement:

Incoming information suggests that economic growth is slowing, reflecting the intensification of the housing correction and some softening in business and consumer spending. Moreover, strains in financial markets have increased in recent weeks. Today's action, combined with the policy actions taken earlier, should help promote moderate growth over time.

Readings on core inflation have improved modestly this year, but elevated energy and commodity prices, among other factors, may put upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.

Recent developments, including the deterioration in financial market conditions, have increased the uncertainty surrounding the outlook for economic growth and inflation. The Committee will continue to assess the effects of financial and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth.

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