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FIRST Trust ADVISORS L.P.

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Monday Morning Outlook

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Bad Mood about the Economy Unwarranted

The mood on, and off, Wall Street is dour. From recent peaks the S&P 500 is down 10%, the Dow is off 11% and the Nasdaq has fallen 13%. High-yield bond spreads have widened as Treasury yields have tumbled.

Market fears are driven by two inter-related issues. First, there is an implicit assumption that credit market problems will continue to worsen. Second, many investors have become convinced a serious economic slowdown is underway. Worst of all, these issues aggravate each other, increasing fears of a downward spiral.

Instead of calming the waters last week, Federal Reserve Chairman Ben Bernanke said, “the baseline outlook for real activity in 2008 has worsened” and “the financial situation remains fragile.” These statements convinced the market that the Fed will cut rates again on January 30th, probably by 50 basis points – pushing the funds rate down to 3.75%.

At first, the news from the Fed pushed equities up. But, on second thought, the market seems to have decided the Fed knows things that it doesn’t, and then fears increased.

The mood is so bleak that investors find themselves dwelling on whichever time frame makes the economic news look the worst. For example, the consensus forecast of a meager 0.1% gain in December retail sales, ex-autos, worries many, yet they ignore the fact that this forecast puts sales 6.2% above last year, a slightly faster pace of growth than the 5.9% pace between December 2005 and December 2006. At the same time, it is often reported that total car and truck sales are down 3% in December from year-ago levels, even though vehicle sales in December rose from November, and were an annualized 6.4% higher in the fourth quarter over the third quarter.

When it comes to analyzing corporate or industry news pessimistic investors focus on weak same-store sales and ignore stronger total sales. And yes, the employment report was on the weak side in December, but initial claims have fallen back to 322,000.

We can’t change the mood on Wall Street. What we can do is look at the fundamental drivers of the economy. And those drivers appear in good shape.

First, the Fed is not tight. In fact, no matter what interest rate we look at, they are all well below levels that existed between 1996 and 2000, when the economy was booming. Moreover, the Fed is clearly willing to cut rates again.

Second, tax rates remain low, helping to fuel strong productivity growth. The US continues to move through an amazing period of technological revolution.

Third, while financial problems exist, we know that total losses from sub-prime loans will pale in comparison to an economy that will produce $14.5 trillion in GDP this year, has 300 million people, 100+ million homes, and more than $100 trillion in total assets. It’s just too big to be knocked off course by the current raft of financial problems.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-15 / 7:30 am	PPI – Dec	+0.2%	**+0.2%**		3.2%
7:30 am	"Core" PPI – Dec	+0.2%	**+0.1%**		+0.4%
7:30 am	Retail Sales – Dec	+0.1%	**+0.3%**		+1.2%
7:30 am	"Core" Retail Sales – Dec	+0.1%	**-0.1%**		+1.8%
7:30 am	Empire State Mfg Index - Jan	8.6	**15.0**		10.3
9:00 am	Business Inventories - Nov	+0.4%	**+0.6%**		+0.1%
1-16 / 7:30 am	CPI – Dec	+0.2%	**+0.2%**		+0.8%
7:30 am	"Core" CPI – Dec	+0.2%	**+0.2%**		+0.3%
8:15 am	Industrial Production - Dec	-0.1%	**-0.1%**		+0.3%
8:15 am	Capacity Utilization – Dec	81.3%	**81.2%**		81.5%
1-17 / 7:30 am	Housing Starts – Dec	1.150 Mil	**1.124 Mil**		1.187 Mil
7:30 am	Initial Claims - Jan 12	334K	**332K**		332K
9:00 am	Philly Fed Survey – Jan	0.0	**0.0**		-5.7
1-18 / 9:00 am	U. Mich. Consumer Sentiment	74.9	**75.0**		75.5
9:00 am	Leading Indicators - Dec	-0.2%	**-0.1%**		-0.4%