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First Trust Advisors L.P.

Dec. 25 2006

Monday Morning Outlook

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-27 / 9:00 am	Nov New Home Sales	1.01 Mil.	990K		1.004 Mil
12-28 / 9:00 am	Nov Existing Home Sales	6.19 Mil.	6.10 Mil		6.241 Mil
9:00 am	Dec Chicago PMI	50.3	50.3		49.9

A New Year Cometh

It's a fate of the calendar and a result of our reflective nature that causes many otherwise "in the moment" people to both look back and ahead at the end of every year.

In our business this means comparing our forecast to reality, and thinking about what this means for the future.

Sometimes this is encouraging, such as our January 12, 2006 forecast (when the Dow was under 11,000) of a 12,500 Dow by year-end. With the Dow currently at 12,390, and the S&P 500 up 13.3% so far this year, we are clearly proud of that forecast.

But forecasting is a humbling profession, and our prediction of a 5.95% year-end 10-year Treasury bond yield was well off the mark. With the 10-year yield at 4.58%, and the yield curve inverted, we are reminded that markets are a deep and often mysterious mechanism.

Housing activity declined more sharply than we anticipated in 2006, and this caused our 3.5% to 4.0% real GDP forecast to be overly optimistic. Real GDP has grown just 2.3% at an annual rate in the past two quarters. However, real GDP, excluding housing, averaged 3.3% growth in Q2 and Q3, suggesting that the non-housing related economy remained strong.

This helps explain why our better-than-consensus forecast of corporate profits and our lower-than-consensus estimate of the unemployment rate look pretty good.

Inflation is a mixed bag. We expected rising inflationary pressures in 2006, but plummeting oil prices have pulled the year-over-year change in the consumer price index (CPI) down from over 4% to less than 2%. Nonetheless, the "core" CPI, which increased just 2.2% in 2005, is now growing at a 2.6% year-over-year growth rate. While below our forecast, these two measures of inflation point in different directions.

Analyzing the past is only so helpful because it is the future that investors really care about. In that regard, not much has changed. We do not view the weak housing market as indicative of serious economic problems. The housing market was boosted above trend by extremely low interest rates, which pulled growth forward. Now that rates are back to more normal levels, the housing market is paying the price.

In other words, problems in the housing market are not a reflection of excessively tight money. There is no evidence that the world or US economy suffers from a shortage of liquidity. In fact, Thailand injured its markets last week by trying to slow down capital inflows and an appreciating currency–almost the exact opposite of its problems in 1997 and 1998.

Tax rates remain low and our models suggest that monetary policy is still not too tight. As a result, our forecast looks for roughly 3.5% real GDP growth and 3.5% "core" inflation in 2007. While we have pulled back our bond forecast, we still expect the 10-year Treasury yield to rise above 5.5% next year, and look for three more Fed rate hikes. We continue to believe that the broad US equity market is undervalued by roughly 30%, and we expect 12% to 15% equity price appreciation next year. Call it a 14,000 Dow.

Week of January 1, 2007

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-2 / 9:00 am	Dec ISM Index	50.1	49.5		49.5
1-3 / 9:00 am	Construction Spending	-0.4%	-0.2%		-1.0%
Sometime	Domestic Car Sales	5.2 Mil.	5.2 Mil.		5.1 Mil.
during the day	Domestic Truck Sales	7.2 Mil.	7.3 Mil.		7.2 Mil.
1-4 / 9:00 am	Nov Factory Orders	+1.8%	+2.0%		-4.7%
9:00 am	ISM Non-Manufacturing	57.5	59.0		58.9
1-5 / 7:30 am	Non-Farm Payrolls	+115K	+110K		+132K
7:30 am	Manufacturing Payrolls	-10K	-10K		-15K
1-5 / 7:30 am	Unemployment Rate	4.5%	4.5%		4.5%
7:30 am	Average Hourly Earnings	+0.3%	+0.4%		+0.2%
7:30 am	Average Weekly Hours	33.9	33.9		33.9

Brian S. Wesbury; Chief Economist