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FIRST Trust ADVISORS L.P.

Apr 10, 2006

Monday Morning Outlook

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-12 / 7:30 am	Feb Trade Balance	-$67.5B	-$66.5B		-$68.5B
4-13 / 7:30 am	Mar Import Prices	+0.2%	+0.4%		-0.5%
	Mar Export Prices	+0.1%	+0.3%		0.0%
	Mar Retail Sales	+0.5%	+0.6%		-1.3%
	Mar Retail Sales Ex Autos	+0.4%	+0.5%		-0.4%
	Feb Business Inventories	+0.3%	+0.5%		+0.4%
	Initial Unemployment Claims	300K	295K		299K
4-14 / 9:00 am	Mar Industrial Production	+0.5%	+0.7%		+0.7%
	Mar Capacity Utilization	81.4%	81.6%		81.2%

The Conundrum Unwinds Rapidly

Alan Greenspan called it a conundrum, and in a recent speech, Fed Chairman Ben Bernanke said it was "historically unusual behavior." They were not talking about two-time, left-handed Masters Champion Phil Mickelson, but instead were referring to low long-term interest rates despite many Fed rate hikes, a strong economy and increasing inflationary pressures.

Some say that low long-term rates and a flat (sometimes inverted) yield curve signal economic problems and no threat from inflation because the Fed has already tightened too much.

Others, including Ben Bernanke, have posited the existence of a "global savings glut." This savings glut, which is related loosely to the large US trade deficit, supposedly boosts foreign demand for US securities, holding down long-term rates.

Our view is that the bond market has been overvalued due to an excessively accommodative (and transparent) Fed policy, a very pessimistic economic forecast and an overly optimistic view that inflation had been tamed by productivity and globalization. These developments encouraged the use of a massive amount of bond market leverage in the form of the "carry trade."

Slowly, but surely, these underpinnings have been knocked out from under the bond bulls. The Fed has pushed rates up much more than most economists predicted. The unemployment rate fell to 4.65% in March, a new low for this recovery, and below the Fed's year-end forecast of 4.75%. The economy has remained much more resilient than the conventional wisdom expected. Moreover, with gold prices above $600/oz., other non-oil commodity prices booming, and measures of consumer inflation moving higher bit by bit, those employing the "carry trade" have been forced to reassess. As a result, the 10-year Treasury yield reached 4.99% in recent trading, its highest yield since June 2002 and up 66 basis points in just 3 months.

Despite what should prove to be a strong earnings season (we expect S&P 500 earnings increased between 12% and 15% from a year-ago during the first quarter), the stock market reacted poorly to rising bond yields on Friday. This is not a surprising development. Rising interest rates impact stock valuations because they lower the present value of any future earnings. However, our capitalized profits model, even when we use a 10-year Treasury yield of 6% (a level we think appropriate) continues to show that broad US equity indices remain roughly 25% undervalued.

Rising bond yields and Fed tightening are not as negative for the market as many analysts believe. Rising bond yields signal a growing economy, with high returns to capital. Moreover, as the "carry trade" unwinds, the Treasury yield curve is steepening, suggesting that the inversion of the yield curve was a trading-related phenomenon, not a signal of imminent economic problems.

In addition, equity analysts have fretted about Fed rate hikes since they began in June 2004 – saying things like, "equity markets always have trouble when the Fed hikes rates." But, since the first rate hike, the S&P 500 index has climbed 13.6%, the NASDAQ is up 14.2%, and small-cap stocks as measured by the S&P 600 are up 31.9%. Between 1995 and 1999, the federal funds rate averaged 5.4%, while the 10-year Treasury yield averaged 6.1%. These rates did not stop the economy and stock market from booming back then; and an unwinding of the conundrum is nothing to fear today.

Week of April 17, 2006

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-17 / 7:30 am	Apr Empire State Mfg Survey	23.8	25.0		31.2
4-18 / 7:30 am	Mar Housing Starts	2.05M	2.05M		2.12M
	Mar PPI	+0.4%	+0.4%		-1.4%
	Mar "Core" PPI	+0.2%	+0.3%		+0.3%
4-19 / 7:30 am	Mar Leading Indicators	+0.1%	+0.2%		-0.2%
	Mae CPI	+0.4%	+0.4%		+0.1%
	Mar "Core" CPI	+0.2%	+0.3%		+0.1%

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Consensus forecasts come from Insight Economics, LLC