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FIRST Trust ADVISORS L.P.

Apr 3, 2006

Monday Morning Outlook

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-3 / 9:00 am	Feb Construction Spending	+0.5%	0.0%	**+0.8%**	+0.4% - r
	Mar ISM Index	57.5	58.0	**55.2**	56.7
	Mar Domestic Auto Sales	5.5M	5.5M		5.4M
	Mar Domestic Light Truck Sales	7.8M	7.8M		7.8M
4-5 / 9:00 am	Mar ISM Non-Mfg Survey	59.0	61.0		60.1
4-6 / 7:30 am	Initial Unemployment Claims	300K	297K		302K
4-7 / 7:30 am	Mar Non-farm Payrolls	+194K	+210K		+243K
	Mar Manufacturing Payrolls	+3K	+6K		-1K
	Mar Unemployment Rate	4.8%	4.7%		4.8%
	Mar Average Hourly Earnings	+0.3%	+0.3%		+0.3%
	Mar Weekly Hours	33.8	33.8		33.7

The Canary in the Coal Mine

The Fed's strategy of managing monetary policy is like caviar – elaborate and mysterious at first blush, but in reality just fish eggs. The Fed has hundreds of economists and decades of learning, but monetary policy is still managed with a rough version of the Phillips Curve – a simple theory that unemployment and inflation are inversely related. When the unemployment rate falls below some theoretical floor, upward pressure on wages creates inflation. In other words, growth causes inflation.

This theory has fostered a great many buzzwords. Terms like "slack," "capacity constraints," "overheating," and "the natural rate of unemployment" show up in the business press and economic analysis almost every day.

Unfortunately, the Phillips Curve has led many investors astray, and caused the Fed to make mistakes. Strong growth, low unemployment and rising wages do not cause inflation. For example, between June 1992 and April 2000, the unemployment rate declined steadily from 7.8% to 3.8%, wages grew rapidly and the economy boomed. Yet, inflation remained low and long-term interest rates fell. The Fed lifted rates in 1999/2000 anyway, because Phillips Curve models predicted inflation. Instead, the US experienced its first near death brush with deflation since the 1930s.

The biggest problem with the Phillips Curve is that it assumes most changes in the unemployment rate or economic growth are caused by monetary policy. While this is true in the very short-term, changes in tax rates, regulations, or technology are the real catalysts for economic change. The economy boomed and unemployment fell in the 1990s because of massive gains in productivity, not because of an accommodative Fed policy.

Real interest rates and commodity prices (especially gold) have been much better indicators of Fed policy and the true risk of inflation. In the late 1990s, the real federal funds rate was high, while commodity and gold prices fell. These indicators made it clear that deflation was a greater threat than inflation, which contradicted the Phillips Curve approach.

Today, even after 15 consecutive rate hikes, the real federal funds rate, calculated by subtracting the PCE deflator, is only 1.9% - well below the 30-year average of 2.7%. In addition, commodity prices have surged, and last week gold moved above $590/oz for the first time in 25 years. Commodity prices and gold clearly suggest that monetary policy remains accommodative.

Gold is like the canary in the coal mine – a warning signal that inflationary or deflationary pressures are building and a much better tool than the unemployment rate. Interestingly, the official statement released by the FOMC after Chairman Bernanke's first meeting last week, mentioned commodity prices – the first and only time the official statement has ever made this reference. While the statement was still filled with Phillips Curve related language, the nod toward commodity prices is a significant positive. The Fed needs a forward looking tool to help avoid fighting the last monetary war. This may explain why, after an initial decline following the rate hike last Tuesday, stock markets rebounded. Using commodity prices will significantly decrease the risk of Fed mistakes.

Week of April 10, 2006

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-12 / 7:30 am	Feb Trade Balance	-$67.0B	-$66.5B		$68.5B
4-13 / 7:30 am	Mar Import Prices	+0.3%	+0.5%		-0.5%
	Mar Export Prices	+0.1%	+0.3%		0.0%
	Mar Retail Sales	+0.7%	+0.4%		-1.3%
	Mar Retail Sales Ex Autos	+0.5%	+0.4%		-0.4%
4-14 / 9:00 am	Mar Industrial Production	+0.3%	+0.4%		+0.7%
	Mar Capacity Utilization	81.4%	81.5%		81.2%

Brian S. Wesbury; Chief Economist **Bill Mulvihill; Senior Economist**