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FIRST Trust ADVISORS L.P.

Jun 26, 2006

Monday Morning Outlook

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-26 / 9:00 am	May New Home Sales	1.150M	1.120M	**1.234M**	1.180M - r
6-27 / 9:00 am	May Existing Home Sales	6.65M	6.7M		6.76M
6-29 / 7:30 am	Q1 Real GDP: Final	5.6%	5.8%		+5.3%
	Q1 GDP Price Index: Final	3.3%	3.3%		+3.3%
	Initial Unemployment Claims	305K	300K		308K
1:15 pm	FOMC Meeting	5.25%	5.25%		5.00%
6-30 / 7:30 am	May Personal Income	+0.2%	0.4%		+0.5%
	May Personal Consumption	+0.3%	0.3%		+0.6%
9:00 am	Jun Chicago PMI	59.0	60.0		61.5

The Fed is on the Mound, Stocks Are Undervalued

The Fed will meet again this week and it is a virtual certainty that the target federal funds rate will be raised to 5.25% - the 17th consecutive ¼ pt. rate hike in the past two years. It remains our view that this rate hike is a positive for the economy, not a negative. The federal funds rate is still below neutral, and it must be raised to control inflationary pressures in the years ahead.

Ever since June 2004, when the Fed first began to lift rates, there have been many who felt that the stock market could not move higher as long as the Fed was tightening. In addition, the market has had to battle surging energy prices, the evacuation of the 35th largest U.S. city following a hurricane, fears of a housing bubble and rising mortgage rates, nuclear threats, bird flu and political turmoil.

Yet, none of this kept equity prices from rising. The S&P 500 is up about 13% (excluding dividends) since the Fed started lifting rates, while the S&P 600 small cap index is up roughly 25%.

There are three reasons for this. First, productivity is booming. Second, corporate profits are growing at a near record pace. Third, monetary policy is not tight, it is just less loose - real interest rates remain very low.

Rising productivity allows the economy to absorb hits without slowing. In a static world, a 50% increase in the price of oil or natural gas in a 12 month period would reduce profits by 5% for a company that spends 10% of its operating costs on energy. But if productivity is rising by 5% per year, then profits will not fall even if prices to customers remain stable. This dynamic has sharply increased profits in recent years, especially as pricing power returns.

In the first quarter of this year, overall economy-wide after-tax corporate profits, adjusted for inventory valuation and depreciation, were $1,155.1 billion, more than double the $551.8 billion in the first quarter of 2000 when stock markets were peaking.

The S&P 500 hit its record high close on March 24, 2000 at 1527.5, but closed Friday at just 1244.1 – well below the peak. Based on trailing earnings, the P/E ratio for the S&P 500 was 29.4 in the first quarter of 2000, and is currently 16.7. Based on expected earnings, the P/E-ratio for the S&P 500 is near 14.5.

From 30,000 feet, our basic capitalized profits model suggests that the overall US stock market is significantly undervalued. Our model takes current after-tax corporate profits and divides by our best estimate of fundamental interest rates. Currently, we are using a 10-year Treasury bond yield of 6% as a discount rate. This model suggests that the broad-based US equity market is roughly 30% undervalued.

Our models also suggest that the Federal Reserve has not tightened too much and that the economy and corporate profit growth will remain strong well into 2007. As a result, we view any market stumble due to continued fears about Fed tightening as a buying opportunity. The Fed may be throwing fast balls, but the wind is blowing out, and toward right field. Keep the faith.

Week of July 3, 2006

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-3 / 7:30 am	May Construction Spending	0.3%	0.1%		-0.1%
9:00 an	Jun ISM Manufacturing Index	55.0	57.5		54.4
Sometime During	Domestic Auto Sales	5.5M	5.5M		5.3M
the Day	Domestic Light Truck Sales	7.2M	7.1M		7.0M
7-5 / 7:30 am	May Factory Orders	0.3%	0.4%		-1.8%
7-6 / 7:30 am	Jun ISM Non-Man	60.0	61.2		60.1
7-7 / 7:30 am	Jun Non-Farm Payrolls	165K	195K		+75K
	Jun Manufacturing Payrolls	0K	5K		-14K
	Jun Unemployment Rate	4.6%	4.6%		4.6%
	Jun Average Hourly Earnings	+0.3%	+0.4%		+0.1%
	Jun Weekly Hours	33.8	33.8		33.8

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