

Jul 17, 2006

Monday Morning Outlook

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-17 / 8:15 am	Jun Industrial Production	+0.5%	+0.5%	+0.8%	+0.1% - r
	Jun Capacity Utilization	82.0%	82.0%	82.4%	81.8% - r
7-18 / 7:30 am	Jun PPI	+0.3%	+0.4%		+0.2%
	Jun "Core" PPI	+0.2%	+0.3%		+0.3%
7-19 / 7:30 am	Jun CPI	+0.2%	+0.2%		+0.4%
	Jun "Core" CPI	+0.2%	+0.2%		+0.3%
	Jun Housing Starts	1.900M	1.950M		1.957M
9:00 am	Humphrey Hawkins Report				
7-20 / 7:30 am	Initial Unemployment Claims	322K	320K		332K
1:00 pm	Minutes of June FOMC Meeting				

Don't Fear the "R" Word

This may be the most underappreciated recovery in history. Time and time again, investors and mainstream media seem to give up hope, so much so that we began to call them the Pouting Pundits of Pessimism. The most recent evidence of this was a front page story in the Saturday (7/15/2006) edition of The Wall Street Journal, titled "Consumer Caution, Oil Prices Increase Risk of Recession."

The R Word!!; on the front page of the world's leading business newspaper? The same newspaper, whose panel of 56 economists forecast less than a month ago that US real GDP growth would average 2.75% through mid-2007. Only one economist in that panel forecast a negative quarter of growth (for Q2-2007). That's it; almost every other forecaster puts a two or three-handle (sometimes four) on their real GDP forecast.

While we have no idea of the actual driving forces behind each of the 56 economists' forecasts, we do know what bothers the WSJ reporters who wrote about "recession". They fear Fed tightening and rising interest rates, increasing oil prices, a war in the Mid-East, a slowdown in the housing market, slow earnings growth, consumer debt, and an inverted yield curve.

Two things stand out in this list. First, other than renewed fighting in the Mid-East, none of these conditions are new. They have been staples of pessimistic forecasting for the past three years. Second, they are all discussed in terms of their demand-side impact.

What's missing is any focus on the supply-side of the economy. Productivity, profits and business investment are all strong. Productivity bounces around from quarter to quarter, but non-financial corporate sector productivity is up 4% at an annual rate in the past five years. This is why the economy is so resilient.

Corporate profits are at an all-time high share of GDP, and after the first week of earnings season, 70% of reporting companies

Week of July 24, 2006

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-25 / 9:00 am	Jun Existing Home Sales	6.60M	6.60M		6.67M
7-27 / 7:30 am	Jun Durable Goods Orders	+1.9%	2.2%		-0.2%
9:00 am	Jun New Home Sales	1.17M	1.19M		1.23M
7-28 / 7:30 am	Q2 Real GDP: Advanced	+3.1%	+3.0%		+5.6%
	Q2 GDP Price Index: Advanced	+3.7%	+4.2%		+3.1%

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Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.

have beat analysts estimates. Commercial and industrial loans are up 15.3% at an annual rate so far this year – a level of growth not seen since the go-go nineties.

Excluding transportation, new orders for durable goods are up 9.6% at an annual rate in the first five months of 2006, while unfilled orders are up 12.8%. Industrial production surged 0.8% in June – the US manufacturing sector has *never* produced more "stuff." Private non-residential construction is up 12.7% in the past year, while lodging construction (hotels) has surged 51%. All of this is offsetting a slowdown in housing.

For those who believe in Say's Law – that, "Supply creates its own demand" the economy is strong, not weak. Despite the fact that the consumer is 70% of GDP, the odds of recession are extremely low because the entrepreneurial spirit is alive and well. The economy will remain healthy as long as taxes remain low and the economy free of over regulation or protectionism.

Yes, June retail sales fell 0.1%, but during the first 55 months of this recovery, retail sales have fallen 18 times. Investors should not overreact to one month's decline.

The household survey of employment reports much stronger job growth than the establishment survey because it picks up small business and self-employment more accurately. The unemployment rate is 4.6%, an extremely low level.

Productivity growth is allowing the economy to absorb rising energy prices and higher interest rates and will continue to do so for many quarters to come.

While the pull back in equities has increased concern amongst investors, we believe it has created a great buying opportunity. Investors that take advantage of this situation should once again be richly rewarded – the 2 "R" words on our mind.