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FIRST Trust ADVISORS L.P.

Aug 14, 2006

Monday Morning Outlook

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-15 / 7:30 am	Jul PPI	+0.4%	+0.4%		+0.5%
	Jul "Core" PPI	+0.2%	+0.3%		+0.2%
	Aug NY Fed Survey	14.9	16.0		15.6
8-16 / 7:30 am	Jul CPI	+0.4%	+0.5%		+0.2%
	Jul "Core" CPI	+0.3%	+0.3%		+0.3%
	Jul Housing Starts	1.81M	1.85M		1.85M
8:15 am	Jul Industrial Production	+0.6%	+0.7%		+0.8%
	Jul Capacity Utilization	82.7%	82.8%		82.4%
8-17 / 7:30 am	Initial Unemployment Claims	315K	310K		319K
	Jul Leading Indicators	+0.1%	+0.1%		+0.1%
11:00 am	Aug Philly Fed Survey	8.3	7.5		6.0

Don't Try So Hard, Have Faith

The biggest danger facing the US economy today is that so many people think there is something wrong. It's dangerous because when people think there is something wrong, they try to fix it. Very often, these good intentions have bad consequences.

Low tax rates, limited regulation, small government, and a stable currency are the best recipe for increasing standards of living and accelerating wealth creation. In other words, if the government stops meddling and allows entrepreneurs to be rewarded for their risk-taking, wealth will be created.

This is counterintuitive for those who believe in the Keynesian, demand-side view of the world. They believe in "market failure" and think that the economy will wobble out control if it is not managed or controlled. Everywhere they look, something needs to be fixed, fine-tuned or just plain up-ended.

The budget deficit means that tax rates are too low. The trade deficit means that the dollar is too strong. The housing slowdown means that interest rates have been hiked too much. Rising inflation means that the economy needs to slow down. Rising oil prices mean that we need to tax gasoline or energy companies more, subsidize alternative fuels and mandate better gas mileage.

The heyday for this kind of thinking was between 1965 and 1980. Great Society entitlement spending was complemented by a massive system of regulation, very easy monetary policy and high tax rates. The result was stagflation. Twenty-five years ago, the US cut tax rates and rolled-back regulation, while the Fed followed a tight money policy. The problem was solved. Have we forgotten?

Tax revenue this year will be a record $2.4 trillion – $400 billion more than in 2000. Spending, on the other hand, will be up by $900 billion. For deficit-hawks, spending is the real problem. Tax hikes will harm the economy.

While many believe that a weaker dollar is necessary to shrink the trade deficit, this artificial fix causes problems. Weakening the dollar reduces American standards of living in the global economy. A weaker dollar means the US must trade more of what it produces to get the same amount of imports. How is that good? No country in the history of the world has ever devalued itself to prosperity. Look around the world. Europe has a trade surplus, but anemic growth and unemployment rates near 10%. A trade surplus is not a panacea.

Higher prices are already causing demand for energy to slow, but supply is hard to expand because government regulations inhibit exploration, production and the transportation of energy.

The housing market is soft, but after nearly a decade of uninterrupted growth this is to be expected. Moreover, complaints about high interest rates are almost laughable. Interest rates today are still well below levels of the late 1990s. They only appear high when compared to the absurdly low rates of 2002 to 2004.

Lastly, strong economic growth does not cause inflation. Inflation is a monetary phenomenon. Inflation can exist in a strong or weak economy. However, inflation erodes living standards and undermines the foundation of the economy. A stable currency is essential to long-term economic success.

The bottom-line is that if you think there is something wrong with the economy today, just wait until someone tries to fix it. Raising tax rates, reducing the value of the dollar, restricting trade, continuing to run an easy monetary policy, and interfering with the energy market would turn back the clock to 1970s-style stagflation.

Letting things be, is the right policy. As July retail sales data show, the consumer and the economy are still humming along. Early data suggest that third quarter real GDP is likely to grow near 3.5%. Tax revenues continue to surge and corporate profits are strong. Have faith – the economy is in great shape. But if you must do something, slow the growth in government spending and make certain that Fed policy does not create inflation.

Week of August 21, 2006

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-22 / 9:00 am	Jul Existing Home Sales	6.60M	6.60M		6.62M
8-23 / 7:30 am	Jul Durable Goods	+0.3%	+0.3%		+3.1%
8-24 / 9:00 am	Jul New Home Sales	1.10M	1.12M		1.13M

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