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FIRST Trust ADVISORS L.P.

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Monday Morning Outlook

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-25 / 9:00 am	Aug Existing Home Sales	6.20M	6.28M		6.33M
9-27 / 7:30 am	Aug Durable Goods Orders	+0.5%	+0.6%		-2.5%
9:00 am	Aug New Home Sales	1.04M	1.02M		1.07M
9-28 / 7:30 am	Q2 Real GDP: Final	+2.9%	+3.0%		+2.9%
	Q2 GDP Price Index: Final	+3.3%	+3.3%		+3.3%
	Initial Unemployment Claims	315K	312K		318K
9-29 / 7:30 am	Aug Personal Income	+0.3%	+0.4%		+0.5%
	Aug Personal Outlays	+0.2%	+0.2%		+0.8%
9:00 am	Sep Chicago PMI	55.7	55.0		57.1

Fed Ease in 2007?

What a difference one little piece of data makes. Last Monday, the 10-year Treasury yield was 4.81%. With the CPI up 3.82% in the past year, the inflation adjusted 10-year yield was 0.99%. It seemed hard to believe that the 10-year yield could go much lower. But last week, bond prices soared and the 10-year yield fell to 4.59%.

The catalyst for this decline was a drop in the Philadelphia Fed survey for September to -0.4. A negative reading on the index indicates a contraction in manufacturing activity in the Philadelphia area. The September reading was the first contraction in this index since April 2003, which was before the tax cut on capital gains and dividends.

For some reason, markets have been walking on egg shells since the beginning of this recovery and seem to give more credence to weak data than strong data. Nonetheless, the overreaction to the Philly Fed survey is somewhat stunning. Just a few days before, the New York Fed September survey rose to 13.8, and was ignored.

The 10-year yield is now 66 basis points below the federal funds rate. In the past, an inverted yield curve has signaled tight monetary policy and the futures markets are now pricing in a Fed rate cut by the spring of 2007.

Our typical inclination is to trust the markets. But markets are sending mixed signals. For example, when the yield curve inverted prior to the 1990/91 and 2000/01 recessions, the price of gold was falling. And while it is true that the price of gold has fallen from its speculative peak of $720/oz. in May of this year, it is still up 7.6% this year and 35% from mid-2005. With gold up this much in the past 18 months, it is hard to believe that money is tight.

Some are looking at monetary base growth, which slowed to a 6-month annualized growth rate of 0.5% in August. But the monetary base has not been a trustworthy indicator of Fed policy. In July 1990, when the economy slipped into recession, the monetary base had grown by 8.8% at an annual rate in the prior six months. And in March 2001 (the official beginning of that recession), the 6-month annualized rate of change in the monetary base was 5.3%.

Last year, in May 2005, the monetary base grew at a 6-month annualized rate of just 1.7%, which led some to argue that money was too tight. But the economy continued to grow despite high energy prices and devastating hurricanes. In other words, the slowdown in monetary base growth during 2006 may not be an indicator of anything.

While it seems clear that the economy is showing some sign of moderation, we do not expect any serious slowdown in economic activity. Productivity, profits and business investment continue to grow strongly, while initial unemployment claims signals a robust labor market.

Moreover, inflationary pressures continue to build. Even though energy prices have fallen sharply, the prices paid index from the Philadelphia Fed survey was 38.1 in September, well above its 17.2 reading in March of this year. With inflationary pressures still strong, we remain concerned that the bond market is underestimating the level of future interest rates. Our models continue to suggest that a neutral federal funds rate is 6% and any rate cut in 2007 is unlikely.

Week of October 2, 2006

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-2 / 9:00 am	Sep ISM Index	53.5	53.0		54.5
Sometime During	Sep Domestic Auto Sales	5.5M	5.5M		5.3M
the Day	Sep Domestic Light Truck Sales	7.2M	7.1M		7.1M
10-4 / 9:00 am	Sep ISM Non-Manu Index	56.0	56.5		57.0
10-6 / 7:30 am	Sep Non-Farm Payrolls	+123K	+140K		+128K
	Sep Manufacturing Payrolls	0K	+3K		-11K
	Sep Unemployment Rate	4.7%	4.6%		4.7%
	Sep Average Hourly Earnings	+0.3%	+0.3%		+0.1%
	Sep Weekly Hours	33.8	33.8		33.8

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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.