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FIRST Trust ADVISORS L.P.

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Monday Morning Outlook

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Expect the Unexpected

Despite two straight quarters of first-rate economic growth, many analysts and commentators think the US economy has been knocked on its back, the ten-count has begun, and it may never get up.

The reason so many are overlooking real GDP growth of 3.8% in the second quarter and 4.9% in the third is that consumption flattened out in September and October. This fits the conventional wisdom that housing and credit problems have knocked the economy for a loop. The consensus among economists, including at the Federal Reserve, is that fourth quarter growth will be just 0.5%. Some are even arguing that the economy will contract, the first negative quarter since 2001.

Nonetheless, we still believe the economy is in good shape and expect real GDP to grow between 1.5% and 2.0% at an annual rate in Q4. Yes, this is below trend, but it is partially a payback for above-trend growth in Q2 and Q3. The three quarter average will still be near 3.5%.

More importantly, key monthly data releases are nowhere near recession levels. The ISM Manufacturing Index was at 50.8 in November. At the start of the last recession (March 2001) the index was 42.6. The service sector is also still robust, with the ISM Non-Manufacturing Index at 55.8 in October versus 50.0 in March 2001.

Other key surveys for November say the same thing. The Chicago Purchasing Managers Index, a measure of midwest manufacturing activity, was 52.9 in November versus 37.2 in March 2001. The Philly Fed Index, a measure of manufacturing in the Philadelphia region, was at +8.2 in November versus -20.2 in March 2001.

Remember, as a group, economists are famous for predicting recessions that never materialize and missing recessions even when they have already started. This is not just a string of bad luck or some eerie coincidence.

Consensus recession forecasts don't become the consensus overnight. They usually percolate over several months or even quarters. Businesses, in preparation for the assumed recession, keep inventories lean and refrain from new large investment projects. As a result, unless monetary policy unexpectedly becomes too tight, knocking the legs out from under demand, there are no negative surprises and businesses are in a position to expand.

It's when no one expects a recession that the risk is actually rising. That's when businesses don't fear over-stocking inventories, and when managers have been throwing money at every project they see.

With the exception of home building – which *is* clearly in trouble right now but represents less than 5% of the economy – we see low inventory-sales ratios. In addition, over the past four years businesses have invested a smaller share of their profits than in any other four-year period since at least the late 1940s. In other words, the kind of euphoria that has preceded other recessions does not exist.

It's the forecasters who have the wobbly knees. The economy is still standing.

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Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-3 / 9:00 am	ISM Manufacturing Index - Nov	50.6	**50.0**	***50.8***	50.9
12-3 / *sometime*	Domestic Auto Sales - Nov	5.2 Mil	**5.1 Mil**		5.1 Mil
during the day	Domestic Truck Sales - Nov	7.3 Mil	**6.9 Mil**		7.1 Mil
12-5 / 7:30 am	Q3 Non-Farm Productivity	+5.7%	**+5.5%**		+4.9%
7:30 am	Q3 Unit Labor Costs	-1.0%	**-1.1%**		-0.2%
9:00 am	Factory Orders - Oct	+0.0%	**-0.2%**		+0.2%
9:00 am	ISM Non-Man. - Nov	55.0	**54.4**		55.8
12-6 / 7:30 am	Initial Claims - Dec 1	335K	**330K**		352K
12-7 / 7:30 am	Non-Farm Payrolls - Nov	75K	**25K**		166K
7:30 am	Unemployment Rate - Nov	4.8%	**4.8%**		4.7%
7:30 am	Average Hourly Earnings - Nov	+0.3%	**+0.3%**		+0.2%
7:30 am	Average Weekly Hours - Nov	33.8	**33.8**		33.8
7:30 am	Manufacturing Payrolls - Nov	-15K	**-20K**		-21K