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FIRST Trust ADVISORS L.P.

Mar. 26 2007

Monday Morning Outlook

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-26 / 9:00 am	New Home Sales - Feb	0.985 Mil	**1.016 Mil**	*0.848 Mil*	0.882 Mil
3-28 / 7:30 am	Durable Goods - Feb	+3.5%	**+3.4%**		-8.7%
3-29 / 7:30 am	Q4 GDP Final	2.2%	**2.2%**		2.2%
7:30 am	Q4 GDP Chain Price Index	1.7%	**1.6%**		1.7%
7:30 am	Initial Claims - Mar 24	315K	**321K**		316K
3-30 / 7:30 am	Personal Income - Feb	+0.3%	**+0.2%**		+1.0%
7:30 am	Personal Spending - Feb	+0.3%	**+0.3%**		+0.5%
8:45 am	Chicago PMI – Mar	49.5	**49.6**		47.9
9:00 am	Construction Spending - Feb	-0.4%	**-1.3%**		-0.8%

Inflation and the Fed

In the late 1990s, conventional wisdom was convinced that the Fed was too easy – the consensus believed that if the Fed did not tighten, the economy would overheat, inflation would rise and the stock market bubble would grow. When the Fed tightened in 1999 and 2000, pushing the federal funds rate from 4.75% to 6.5%, the popular business press and a vast majority of analysts agreed wholeheartedly.

Before the Fed hiked rates in 1999, our models suggested the Fed was already tight and that deflation was more likely than inflation. Commodity prices were falling (including gold), the dollar was strong, and real interest rates were high. We also believed the Fed should not attempt to manage stock prices and that "pricking a perceived market bubble" could cause serious economic damage.

The results of the 1999/2000 Fed tightening speak for themselves. The US came closer to outright consumer price deflation than at any time since the Great Depression, a recession unfolded and the stock market collapsed. It is clear in retrospect that the Fed was wrong and so was the conventional wisdom.

While the Fed will never admit its mistake, actions speak louder than words. By cutting the federal funds rate 11 times in 2001, eventually pushing it to 1% in 2003, and fretting about an "unwelcome substantial fall in inflation," the Fed was clearly fixing past mistakes.

But, by driving the federal funds rate too low, holding it there for too long, and then lifting rates too slowly and stopping short of neutral, the Fed has now created inflationary pressures. Nonetheless, the conventional wisdom believes that the Fed has tightened too much and that inflation is not a problem. The conventional wisdom has become so convinced of this that it misinterpreted the Fed's most recent statement.

Following last week's meeting, the FOMC said its "predominant policy concern remains the risk that inflation will fail to moderate." But, because the Fed referred to "future policy adjustments" and not 'additional firming," the market ignored the clear message on inflation and decided that the odds of any more rate hikes were significantly diminished.

We disagree. As in 1999, our models contradict received wisdom. The real federal funds rate (today, roughly 2.5%), is well below the 4%+ that has preceded past recessions, commodity prices are elevated and the dollar remains soft. These are not signs of tight money. Inflation remains a threat and rate cuts remain unlikely.

Week of April 2, 2007

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-2 / 9:00 am	ISM Index - Mar	51.4	**51.2**		52.3
4-3 Sometime	Domestic Auto Sales - Feb	5.2 Mil	**5.2 Mil**		5.1 Mil
During the day	Domestic Truck Sales - Feb	7.2 Mil	**7.6 Mil**		7.7 Mil
4-4 / 9:00 am	Factory Orders - Feb	2.5%	**2.6%**		-5.6%
9:00 am	ISM Non-Man. - Mar	55.0	**56.9**		54.3
4-6 / 7:30 am	Non-Farm Payrolls - Mar	135K	**195K**		97K
7:30 am	Unemployment Rate - Mar	4.6%	**4.5%**		4.5%
7:30 am	Average Hourly Earnings - Mar	+0.3%	**+0.4%**		+0.4%
7:30 am	Average Weekly Hours - Mar	33.8	**33.8**		33.7
7:30 am	Manufacturing Payrolls - Mar	-10K	**-17K**		-14K

Brian S. Wesbury; Chief Economist **Robert Stein, Senior Economist**