630-322-7756
www.ftportfolios.com

May 8, 2006

Monday Morning Outlook

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-10 / 1:15 pm	**FOMC Meeting**	**5.0%**	**5.0%**		**4.75%**
5-11 / 7:30 am	Mar Business Inventories	+0.4%	+0.3%		0.0%
	Apr Retail Sales	+0.7%	+0.8%		+0.6%
	Apr Retail Sales Ex Autos	+0.8%	+1.0%		+0.4%
	Initial Unemployment Claims	315K	312K		322K
5-12 / 7:30 am	Apr Import Prices	+1.0%	+1.2%		-0.4%
	Apr Export Prices	+0.2%	+0.4%		+0.2%
	Mar Trade Balance	-$67.3B	-$66.0B		-$65.7B

Transparency and Inflation Targets

The market has been in an uproar over comments made by Federal Reserve Chairman Ben Bernanke at a Washington soiree in the presence of Robert Hormats of Goldman Sachs, and Maria Bartiromo from CNBC.

Dr. Bernanke reportedly said that the markets had misinterpreted his testimony to the Joint Economic Committee. He said his testimony was designed to create more "flexibility" for the Fed and that any pause in rate hikes would depend on the data.

The venue Bernanke chose to correct perceptions was not the best, but we can understand the Fed's uncertainty and its desire to find a way to escape the language it has used for the past two years. Its models suggest that the economy will slow, and if their forecast is correct, the Fed should stop hiking before it goes too far.

But leading indicators, such as commodity prices suggest that Fed policy is still very accommodative: gold is up $100/oz. in six weeks, consumer price inflation has accelerated and economic data is strong. So, who or what should we believe?

If history is any guide, commodity prices are a much more accurate measure than Fed staff forecasts. Despite employing hundreds of economists and having access to some data not available to the public, Fed models are often very wrong.

Recently released minutes from meetings in 2000, show that as late as May (when the Fed lifted the funds rate to 6.5%), the Fed was still very worried about an overheating economy. In fact, Fed simulations suggested that even an 8% federal funds rate would not slow inflation significantly. But, the Fed had already gone too far: a 6.5% funds rate in 2000 pushed the economy into recession and created deflation.

Apologists for the Fed blame a collapse in the stock market for causing the recession and creating deflation, but Fed staff models in mid-2000 anticipated a 25% decline in the Wilshire 5000 and still predicted that the economy could avoid major problems.

The Wilshire actually fell 23% between March 2000 and March 2001, very close to the Fed's prediction. Yet the economy contracted, and the US had its first brush with deflation since the Great Depression. In fact, fighting deflation became the Fed's number one issue between 2001 and 2003.

All of this was foretold by the commodities markets. The CRB Spot Commodity Price Index fell 24% between May 1996 and May 2000. The price of gold fell from $392/oz. to $275/oz. These markets warned that Fed tightening was a mistake. But the Fed staff ignored these signals.

Today, commodity prices are rising, while the Fed staff is forecasting an economic slowdown. In this environment, a transparent (and honest) Fed creates even more uncertainty. If the Fed were to move toward inflation targeting, some of the market anxiety would diminish. While no one would know exactly what the Fed might do, at least the market would know why.

Week of May 15, 2006

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-15 / 7:30 am	May NY Fed Mfg Survey	17.0	17.0		15.8
5-16 / 7:30 am	Apr Housing Starts	2.00M	2.00M		1.96M
	Apr PPI	+0.5%	+0.8%		+0.5%
	Apr "Core" PPI	+0.2%	+0.3%		+0.1%
8:15 am	Apr Industrial Production	+0.3%	+0.5%		+0.6%
	Apr Capacity Utilization	81.5%	81.6%		81.3%
9:00 am	Apr Leading Indicators	+0.1%	+0.2%		-0.1%
5-17 / 7:30 am	Apr CPI	+0.3%	+0.5%		+0.4%
	Apr "Core" CPI	+0.2%	+0.3%		+0.3%
5-18 / 7:30 am	May Philadelphia Fed Survey	13.5	15		13.2

Brian S. Wesbury; Chief Economist **Bill Mulvihill; Senior Economist**